



Standard Texts
on the Social Market Economy



Gustav Fischer · Stuttgart · New York

Standard Texts on the Social Market Economy

Two Centuries of Discussion

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was edited by
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Preface

*The revolution in our era is marked by the call
for freedom rather than for class warfare.*

Ludwig Erhard. Berlin, January 12, 1965

The aim of this volume of «Standard Texts on the Social Market Economy» is to create a better understanding of West Germany's economic system. We have tried to answer such questions as: what currents of thought inspired and influenced the new economic approach adopted after World War II? What theories stood sponsor to this new departure? What were the main goals? What has been achieved and what problems remain for the future?

Finding an unbroken line of development from the past to the present is no easy task. This compilation of essays and papers describes the various stages along an extended route stretching back for over 200 years. When compiling our reader, we decided to give priority to general texts rather than to those of a strictly specialized nature. Such texts will form the subject of later volumes in this series.

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Part I

The Social Market Economy in Practice

Section I

**The Situation and Aims prior
to the Economic and Currency Reform of 1948**

Elimination of the Collective Economy

Carl Goerdeler

1941

[. . .] After the special detailed accounts which we have just heard, there is little to add about the broad aims of economic policy. This policy should, however, be inspired as much as possible by the recognition that man only lives on what he has won from Nature. The higher the standard of living to which man aspires, the greater the effort that he must undertake with his hands and his brains. The harder and more straightforward our work and the more modest our demands, the faster we shall succeed in overcoming the privations which we have been suffering as a result of the First World War, the dictated Versailles Treaty, the aftermath of the Treaty, the error of judgment, the mismanagement of recent years and the poverty caused by the present War. The second fundament prescribed by Nature is that supreme achievement presupposes supreme endeavour. In trade and industry, endeavour is synonymous with competition. This implies that as many creative and active elements as possible should compete against each other in all sectors of the economy. The third fundament is the perception that man will work all the harder, the clearer the relationship between his performance and his personal fortunes. Only when the lazy face up to their failures and the industrious regard their successes as the great fashioner of their destiny can we expect to see supreme achievements. It follows from this that the most flourishing economy is the one in which the State or some other organization leaves the individual to handle as many risks as possible by refraining from bearing such hazards for him. Hence, there must be no collective economy since that invariably ends in sterility and hunger. What we need, instead, is as many individual sectors and businesses as possible. With this in mind, those responsible for the Government's economic policy must deliberately and actively abstain from overprotecting those engaged in trade and industry. An official at the Ministry of Economics with the task, for example, of reviving the engineering industry must clearly acknowledge that he understands much less of this field than a chief clerk or master craftsman in the factory. After all, the public official will not have to face any

personal consequences if his well-intentioned efforts to provide assistance prove to be a failure. Such an official is therefore the least suitable person for finding a remedy. What, then, are the principal ways in which the Government can help trade and industry? It can best help by arranging for good laws, justice, public order, good conduct and balanced public finances as a safeguard for a stable currency. In addition, the Government's economic policy must be directed towards curbing cartels, syndicates, combines and trusts etc as much as possible and splitting them up into independent enterprises again in order to provide the requisite scope of action for outstanding managers endowed with the necessary creative skills and a profound sense of responsibility.

In a well ordered State and nation, the competitive struggle must not proceed completely without restraint, otherwise it may degenerate into an all-out war with everyone fighting everyone. Competition must be kept fair by means of certain mandatory regulations and prohibitions. The existing laws suffice for this purpose, though they will have to be freed from some of the frills added in recent years.

Not every cartel or similar amalgamation is unhealthy. If it can be shown that a cartel yields considerable economic benefits in that the needs of the people are satisfied by better and cheaper means without this entailing any deterioration in the material and nonmaterial circumstances of the firms' employees, then such an amalgamation should be permitted subject to government control. This supervision should cover the above-named points. Where these benefits no longer accrue, the cartel etc should be dissolved. The same treatment ought to apply to such amalgamations as are necessary to improve the competitive conditions for the German economy on world markets.

All existing laws on economic matters should be examined and amended in accordance with these guidelines. However, it must be emphasized that the changes cannot take place overnight. As long as the shortage of vital goods and raw materials needed for production persists, then the current central planning system will remain. This observation is not intended as an acknowledgment of the quality of such a system. The greatest mistake made was to introduce it in the first place, namely in the form of the four year plan. As has often been demonstrated, this plan bears the responsibility for our present plight. Moreover, after our recent experiences from the First World War, a start should never have been made on the Second one without making sure that the economic resources needed for victory were available. But now that we have reached the point where provision of the necessities of life without which we would starve or freeze are no longer guaranteed, there is no alternative for us but to continue this system of planning. However, all its superimposed organizations should be immediately discarded. All special economic powers must be withdrawn and all competences returned to the relevant ministries and their administrative agencies. There has to be an immediate end to all the superfluous form-filling and the pointless statistics which merely serve to occupy shelf space in central offices. The present system of a planned economy must in future be marked by simplicity, frugality and elasticity. The State's supreme policy in all spheres must consist in overcoming the existing shortages as quickly as possible. To the extent that this policy proves successful, there will be a corresponding reduction in the planned economy until the last vestiges of this system finally disappear one day.

The Economic Needs of Postwar Germany

Ludwig Erhard

1943/44

The real problem lies in the elimination of superfluous purchasing power from the economy. Some readers will agree with my view on the need to honour state debts vis-à-vis private savers and investors, to refund these sums to them via the various intermediary bodies and at the same time to acknowledge how inconceivable and unfair it would be to differentiate between different types of obligations at a subsequent stage. Those who do agree with me will also recognize that the State ought to accept liability for all credit balances maintained by private individuals at the banks, since only such a step will ensure equal treatment for all savers in the widest sense of the term. Only in this way will it prove possible to offset losses from misinvestment without causing extreme distress. In practice, this proposal would imply a requirement for the State to undertake commitments over and above the funds on which it drew during the War: it would thus assume the liabilities of the intermediary bodies (banks) in respect of their contractual relationships with customers. In those cases where these bodies thus relieved of their obligations were in turn creditors to the State, there would automatically arise a possibility of compensation. Inasmuch as the banks etc invested the funds obtained during the War in other private undertakings, they would then become debtors to the State after the latter had discharged their liability for the part of the funds involved.

The author hopes that his proposals will not be deliberately misconstrued to suggest that he is advocating the nationalization of the monetary and banking sectors. He is, in fact, interested in seeing the very reverse happen, i. e. the release of these sectors from an otherwise automatic continuation of governmental tutelage. After all, if private contractual relationships and debts retain their validity and if the impression persists despite the actual economic exigencies that it has been left to the discretion or capacity of the clearing banks or savings banks to satisfy their creditors in this way or the other, it will hardly be possible to find a solution likely to win general approval. The dashed hopes and unfulfilled expectations will engender an alarming degree of resentment against the private savings banks which,

because of their close financial links with the State, can in any case merely act as the latter's executive organs. In such a situation, only the State has the authority and the power to decree those measures which are so indispensable in the interest of establishing orderly relations. Hence, the author's proposal corresponds not only to considerations of expediency and the demand for the creation of clear-cut jurisdiction, but also to the inherent logic of the given circumstances.

But, in this context, we should lay special emphasis on the demand for a socially equitable solution, since recognition of this principle furnishes the safest guarantee for maintaining socio-economic order. Such a line of thought has nothing to do with philanthropy. It rests on very practical considerations although, in the field of social policy, these invariably also hinge in turn upon certain human contingencies and currents of social thought. Those who suffer not only personal sorrow in the War but also great material loss, and then learn afterwards that they have also forfeited the control over their savings or that the rate of interest paid on these assets will have to be a modest one, will only willingly accept such a wide measure of renunciation if the same burdens fall on all other citizens. The State will have to face up to these demands, even though it cannot of course always undertake to adhere to this principle in every single case by excogitating theoretical solutions whose benefits in practice are not worth all the concomitant friction and exasperation. In other words, the settlement of debts ought to take the form of indemnification by rectifying the distribution of burdens previously effected in arbitrary fashion. By the same token, the goal of arriving at an absolutely fair solution (for which no absolute yardstick exists) can only be approximately achieved.

[. . .] As has often been explained, however, the consolidation of debts invariably also involves the neutralization of all forms of superfluous purchasing power in the economy. Moreover, the re-emerging industries in the aftermath of demobilization will then lack the funds needed to set peace-time production going. The main requirements will be the procurement of raw materials and the advance payment of wages prior to the completion of the first series of commercial transactions. Despite the urgent needs of the population, industry will not be able to rely from the beginning on a revealed demand – particularly since private enterprises will have been deprived of their liquid resources and since even the State will not command any real purchasing power during this phase of economic reconstruction. Industry will thus have to produce for a market devoid of any revealed demand and to do so without working capital of its own. In normal economic circumstances, such a situation hardly conduces to stimulate the economy but tends, instead, to bring about stagnation with certain deflationary concomitants. Under such critical circumstances, the private sector of the economy will have to meet its detractors face to face and to pass the crucial test with which it is confronted.

On the face of it, this predicament appears to make it impossible for entrepreneurs to produce more or less at random on such an entirely unreliable basis. Will it then be necessary to implement an official work-creating programme in order to give additional impetus to a flagging economy? The author believes that the answer to this question must be a clear «no». At the same time, this does not imply that the State should refrain from granting credit facilities to private enterprise.

[. . .] What conclusions about the future flow from these findings? It has been repeatedly pointed out in regard to the post-demobilization and consolidation phase that the German economy will have neither financial capital nor liquid working funds nor purchasing power for consumption purposes, but will nevertheless have to engage in a feverish bout of activity. It would seem obvious in the light of recent experience to consider in the first instance the possibility of official action to stimulate the economy, especially since many of the problems facing us will have to be resolved by joint efforts. But in the situation we are describing, the State will have neither the capital nor the genuine purchasing power. Furthermore, the need to clear up public finances will, for the reasons cited above, restrict its scope of action in

regard to the creation of credit facilities. In other words, the State's economic power and initiative are bound by strictly circumscribed limits so that trade and industry will be largely left to their own devices in finding ways of providing a new basis for Germany's economic life by establishing a new gross national product. The private sector of the economy will enjoy a fresh opportunity to demonstrate its skill and it must seize this opportunity in order to refute the criticism sometimes directed against it. Entrepreneurs will once more have to resolve the problem of producing for a market without any purchasing power i. e. devoid of sure sales. Their plight will be rendered even worse by their lack of working funds.

The first question about the type of production which will be necessary is not difficult to answer in view of the looming distress ahead of us. Our first efforts will concern the expeditious and wide-ranging expansion of consumer-goods production. However tight the situation may become in regard to raw materials, sufficient reserves of these primary products will probably be mobilized after military requirements have been met to provide the population with food, clothing and household goods. The next preoccupation will be the production of fresh supplies of primary products and working materials. Thanks to recent technical advances, this problem may prove easier to solve than at first assumed. At any rate, it will be prudent even at this stage to draw up an inventory of available basic commodities.

The next point to consider would, logically, be that of the sequence of production processes. For reasons of convenience, however, we have given prior consideration to the question of raising the requisite financial funds. After all, it is important to recognize that, in setting up the production facilities for the goods needed for direct consumption, the economy does not require any genuine capital resources. What it needs are working funds. To begin with, these merely serve to pay for labour performances. For marketing purposes, such funds are only considered in terms of their purchasing power when the equivalent volume of goods is available. However, the decisive factor for an economy largely deprived of essential consumer goods is to keep the interval between the availability of the working funds and the completion of the goods with which to absorb these funds as short as possible. On this score alone (i. e. the lack of genuine capital), the only really practical steps to begin with will consist in the production of rapidly available and saleable consumer goods. Since the prevailing demand will exclude the possibility of simply amassing the funds derived from the new production of goods, the money spent in this sphere will immediately flow back there and serve to finance further production. Thus, there would appear to be no economic objection to furnishing the consumer-goods industry with such working resources since they do not create any additional inflationary purchasing power, but in fact just sufficient to correspond to production. It is precisely because a peace-time economy just getting under way is relatively easy to survey and because the entire production of consumer goods will be absorbed irrespective of finish or fashion that the risk of blunders may be ruled out from the very beginning. This fact offers a special inducement towards choosing this method of restimulating the economy—a move which will turn out to be all the more effective, the more generously credit facilities are granted and the more rapidly turnover increases.

The Social Aspect of the Economic System

Alfred Müller-Armack

1947

Society today is having to re-assess traditional concepts and admit that its political and economic way of life is in many respects out of date. One of the beliefs which requires serious revision is, in my view, the assumption that in our present situation centrally planned economic management is the only path leading to a better future. In all sections of the economy, even among businessmen, one hears the opinion that (in such a hopeless situation) salvation, if at all possible, can only come through further controls and constraints. A feeling seems to have developed that economic control is the only way of coping with such a grave situation as the present one. And by comparison the more liberal forms of organization almost appear somewhat happy-go-lucky, which one is loath to admit in such times. Notwithstanding all the idealistic concepts of a free society, there has developed a general consensus that the more liberal business structures are products of luxury and surplus and unworthy of serious consideration in this day and age. The immense progress resulting from the free market system which prevailed in the 19th century has been forgotten, as has the speed with which that same system removed the scars of the First World War. It is not even considered worthwhile pondering the reintroduction of that system in a situation like the one we are in today, a system which certainly cannot be said to have produced shortages but, at most, surpluses in all fields, which it was sometimes not capable of checking.

The opinion that a centrally planned economy is superior to a free market economy is now open to very serious doubts. All those now involved in economic activity – whether workers, managers or directors – have experienced developments which place a big question mark over that superiority. For more than ten years, economists have been taking a closer look at the nature and potential of the different economic systems and arriving at a more realistic assessment of central planning than was possible in former times when a free market economy, often enough still judged unfairly, was unfavourably compared with the then ideal concept of economic controls. Not until today, with the real economic and sociological consequences of the system of economic control having been revealed in the course of several

decades, has it been possible to arrive at an objective assessment of economic systems instead of the previous vagueness and prejudice.

The following is an attempt to make an unemotional appraisal of one of the central elements of government control: the question how such central dirigisme, leaving aside the general economic problems, should be judged from the social aspect. After all, it is clearly social motives which prompt the controlling administration, the trade unions, the political parties and many individuals to accept the system's obvious deficiencies, because they believe that the social problem can be resolved and the living conditions of the broad mass of the population improved in this way only. The argument that central planning proves socially superior to a free market system is the last bulwark, as it were, behind which even a crumbling system of economic control upholds its claim to be the only possible approach in an age of social concepts. We shall be well advised to study this question in detail. As some members of the community (even though they see government controls failing their purposes) refuse to abandon their belief in the system's social efficiency whilst the business world consider a more liberal system to be a vital necessity and the force of reality has already shown this to be true and asserted itself accordingly in many sectors of the economy, we now find ourselves moving away from the common ground of jointly held convictions. There arises the danger of economic policy ultimately becoming a battlefield on which the contenders struggle to gain the upper hand instead of being a vehicle of economic reason.

In this situation, it is up to the economists to weld these ever diverging views together again. As the system of government control has proved incapable of resolving economic problems, the two contrasting systems can in my opinion only merge in a market economy which provides effective social safeguards. I have suggested that this new economic system should be called the «Soziale Marktwirtschaft» (the social market economy), and this term has met with widespread approval. Our economic policy will only gain general acceptance if it abandons its excessively ideological stance and tries to establish a basis of common conviction on which it will be possible not only to attain the goals of social justice but also to secure a genuine economic management in place of the present fictitious system. In this context, the committees set up by the chambers of industry and commerce and on which trade unions and entrepreneurs are equally represented could assume considerable importance. This will depend on whether it proves possible to reconcile economic and social aims in an economic system based on industrial peace . . .

[. . .] Any discussion of the economic system in Germany is hampered by the fact that we have grown accustomed to treating such fundamental problems as «ideological» matters – the justice or injustice of which can hardly be a subject of dispute. Moreover, divergent views are seen as an expression of a class interest such as capitalist acquisitiveness. In order to clarify this point, let me first outline the position of the academic economists. The free-market system is currently attracting a great deal of attention among distinguished economists abroad as well as in Germany, not because they have some axe to grind but because they are convinced that it is a very useful tool with which to serve the common interest and fulfil our hope of social justice and individual freedom. It is quite erroneous to see only the ideological aspect of economic issues. The economy is based on production. Human labour is intended to produce goods, not to provide someone with a domain where he can exercise individual powers. The real ideological differences are not, in my view, as great as they are purported to be. At the present time, it is much easier to determine the central aim because there is probably little difference of opinion as to what ought to be done right now. We have to choose the economic system which will ensure the quickest possible recovery, good social services, social peace and individual freedom. We must first ask how far the system of economic control has kept its promise of prosperity and social justice, and then whether this task cannot better be accomplished within the framework of a «social market economy».

The argument that social stability can only be guaranteed by means of government control of the economy is clearly irrational. Neither the obvious affluence produced by a free-market economy in the United States nor the lowering of the living standards for the mass of the population governed by collectivist principles in Eastern Europe seem able to inspire any serious investigation of the causes of this tendency to diverge. Over the past 20 years, economic experts have studied the problem of different economic systems in depth. They (I am thinking in particular of the works of *von Mises, Hayek, Röpke, Eucken* and others) have come to the conclusion that central planning systems suffer from innate deficiencies irrespective of the prevailing political system. The experience of the past decade, including the last two post-war years, has fully confirmed this theoretical diagnosis. For that reason it should now be presented to a wider public.

More than twenty years have passed since *Ludwig von Mises* pointed out that a centrally planned economy, by its very nature, was not capable of acquiring a definitive and solid form. In no way has it fulfilled its essential promise that it would give the broadest sections of the population a stable and settled basis of life. On the contrary, the system of central planning has turned out to be one of restless constraint, proceeding from one case of interference to the next because each interference further disturbs the economic equilibrium which in turn calls for further interventions, and so on – the upshot being a complete paralysis of total central planning. Although the free economy of former times also revealed certain signs of restlessness, it did on the whole strive to stabilize the conditions of trade. At least, it would be most unfair to blame that system for the various fluctuations (some of them the result of economic progress) and to ignore the inconsistency of central planning. The latter system sweeps from one scheme to another, and even its most enthusiastic advocates refuse to regard any of its previous forms – and no doubt least of all the present one – as the ultimate solution. Consequently, the system of central planning, by its nature, is forced to keep on making vain promises. Up to now, it has failed to keep its promise to establish a stable environment of life.

And there is a second point to consider. A scientific analysis of central economic planning has proved the impossibility of a genuine accounting system which has not borrowed features from a previous market economy through the price-freeze mechanism. The system's passionate but irrational advocacy of unconditional price stability reflects its inability to find a method of accounting suited to the different degrees of scarcity of various products. Owing to the fact that, with the advancing age of its borrowed pricing system, it is bound to cast increasing doubt on the exactness of the accounting method, any centrally planned economy inevitably causes a drop in overall productivity. Productivity in Germany is at present 25–30 per cent below pre-war level, but this decline is not a consequence of the food situation only. In fact, it began well before the drastic deterioration of living conditions. The decline is reflected in the lower productivity common to all centrally planned systems, a situation which the authorities usually become aware of at a very late stage because of the lack of a genuine accounting system. Apart from this general decline in productivity, central control slows down the rate of technological advancement. This is partly a result of the suppression of investment, the non-issue of shares, credit controls, and the stipulation of standard types of production; but mostly because of the fact that companies no longer have the essential incentive to go along with technological progress. The sharp drop in the number of bankruptcies, a characteristic feature of central planning, proves that the risk has been taken out of economic activity, which is not subject to the need for progress to the extent that it was under the free market system. Economic controls are thus bound to produce a lower gross national product than is possible under the market system. It could be argued from the point of view of social policy that the significance of this statement can only be decided in terms of the distribution of income and wealth. However,

very much depends on whether this higher GNP would be genuinely distributed among the broad mass of the population and not, as might be feared under a market economy, remain the privilege of a few. Here again, it can be shown by means of Pareto's precisely worded conclusion that the sharing of the GNP has in fact conformed to a relatively constant pattern over the years in regard to the various income groups.

The less affluent classes' share of the national income has at least remained constant. In recent decades, it has also shown a relative increase under the market system so that the rise in the gross national product is unquestionably of general social advantage; and the decline of productivity under a system of economic control just as unquestionably entails a disadvantage from the social point of view. And this is not even taking into account the lowering of living standards involuntarily resulting from the decline in the living standards of the broad sections of the population to be found in all centrally planned economies. Quite irrespective of the motives for this lowering of standards, whether the country produces guns instead of butter or invests excessively in the means of production and government representation, or whether the control machinery is regarded as a means of securing exceptionally high reparation payments, all systems of government control have lowered the general standard of living of the people and it therefore seems that the time has come to explore the fundamental significance of this general proposition.

Of course, if we attempt to arrive at a genuine dialogue with all the social groups concerned, we cannot be content with these general conclusions, however important they may be. Indeed, the various aspects of the social problem have to be considered. It is, after all, not only a problem which concerns the workers. The consumer class in itself gives rise to social issues. In addition, the refugees and those who have been bombed out of their homes represent a separate group. But the integration of young people and of the large surplus of women into the economic life of the country is a very topical variant of the social problem. The situation of people receiving national assistance calls for special consideration; and finally the social problem has assumed a wider significance for the nation as a whole by virtue of the fact that we view our overall situation as one aspect of a general social problem.

The Situation of the Consumer under a System of Economic Controls

Let us begin by examining the situation of the consumer under a centrally planned economy. Especially when government controls were first introduced, consumers were promised state protection. In practice, things turned out to be different, of course. Mere price stability in itself does not provide a conclusive advantage for the consumer because what matters is not whether he receives the goods at a fixed price, but whether he gets them at all and in what quantities. The stabilization of prices everywhere associated with government controls has in all cases done away with the necessity to gear production to the immediate needs of the consumer. The promise to the masses that cheaper goods will be available in unforeseeable quantities has remained unfulfilled. Hence, the situation that arises for the consumer under a system of central planning is roughly as follows:

The fixed pricing system means that he no longer has any direct influence on what is actually produced as he did under the market system. He may not attach very much importance to this loss as long as he is confident that he will receive some economic compensation for this restriction of his freedom. In actual fact, the exclusion of the consumer from this process means that more urgent government policy considerations are brought to bear in the provision of goods and services. The consumer pays for price stability by having to queue to buy things. He finds himself in a highly irrational system of distribution in which, as over the past ten years due to the dwindling volume of overall production, such a large proportion of the nation's production capacity is earmarked for certain priorities that it sooner or later becomes doubtful under any system of central

economic planning whether sufficient supplies will be available for the normal consumer. It would therefore be extremely shortsighted to consider the advantage of price stability – only a «formal pledge» at that – and to ignore the countless disadvantages which are the lot of the normal consumer. They stem partly from the innate constraint of the control system, incapable as it is of boosting production beyond its most urgent requirements, and partly from an obvious indifference on the part of the authorities concerned.

For example, it would have been quite feasible up to the end of the War to maintain supplies of textiles to some extent by reprocessing old materials taken in exchange. Suggestions along these lines went unheeded because the authorities thought the consumers could be ignored. Nor, in the allocation of coal rations last year, does the importance of home heating-fuel as a direct aim of consumption appear to have been properly appreciated. Last year's textile production reveals the same disadvantage suffered by the ultimate consumer. Standardized production had such absolute priority that there was practically nothing left for children's diapers and the darning wool so badly needed by the people. The principle of priorities inherent in any system of central control places the ordinary consumer in a precarious situation. The food ration card No. V issued in the Eastern zone of Germany and the total absence of manufactured goods for the ordinary consumer in the Western zones shows the inevitable course. The fact that all attempts to halt this decline led to yet another disadvantage for customers was demonstrated by the points system applied in the mining industry. The last stocks of industrial goods had to be used up to make the system work. Thus, in a centrally planned economy the consumer has to forfeit more than just the expression of his fashionable whims. He is drawn into a distribution apparatus in which, although making the utmost efforts, he receives less than he would under a free market economy; and in times of crisis his position becomes particularly difficult as he is in danger of being left out of the distribution system altogether.

In the light of this, I do not see any basis for the claim that the system of central control makes special allowance for those consumers who are worst off. What is the point of having stable prices for goods which never reach the consumer? The actual situation today supplies us with the answer to the question whether the centralized system is inclined to give special thought to the weaker members of the community.

Situation of Workers in a centrally controlled Economy

The needs of a worker as a producer of goods cannot be divorced from his needs as a consumer. All the disadvantages experienced by the consumer also affect the worker and must be offset against the possible advantages. The workers see state control as having removed unemployment and they are not entirely wrong. In Germany, the success gained by the totalitarian régime in this respect was the decisive factor for the favourable assessment of planned systems as such. Although this outward appearance of success cannot be denied, it needs to be thoroughly examined in the light of other considerations. The methods of combating economic crises and unemployment were developed in numerous works on economic theory after the First World War. In countries with an explicit free enterprise economy, they have become the subject of major and successful government programmes (as in the United States under *President Roosevelt*). Only in Germany did this process of intellectual preparation fail to exercise any effect, because the free constitutional order had been previously overrun by National Socialism. In terms of the world economy, therefore, the operation of anticyclical policies was by no means confined to countries with planned economies. It is also quite compatible with a market economy. Consequently, we have no need to extol the virtues of state control if we adamantly count steps to roll back unemployment among the mandatory features of any future policy. But one should not

overlook the deficiencies of the procedure for eliminating unemployment adopted within the scope of state controls.

An assessment of unemployment was only possible in totalitarian systems by lowering the standards of evaluating work, which represented the counterpart of formerly openly admitted unemployment under state controls. From the worker's point of view, the fact that the government provides jobs is by no means only to his benefit. Wage freezes applied within the scope of government controls hamper the growth of the individual worker's income as well as overall consumption. But this lowering of the worker's purchasing power as a result of job creation is not the only drawback. In addition, there is the restriction on his freedom in all spheres of life, not only with regard to the trade unions – which under a system of extreme authoritarianism are to all intents and purposes nationalized. A Swiss trade unionist once quite rightly pointed out that a free trade union structure can only thrive in a free market. But almost more important for the individual worker's life in the community are the numerous restrictions on his freedom to choose where he wants to live and work – restrictions which inevitably form part of a system of controls. The freezing of wages under the National Socialists created an excessive demand for labour. This brought not only advantages for the worker. Indeed, it led to that mechanical employment policy which conflicted with the working man's sense of freedom. This government control of labour was by no means a temporary phenomenon of the War. Even British economists have recently confirmed that the full employment policy being considered in Britain cannot be implemented without government control of labour.

Thus, even the achievements of government control were marked by a positive and a negative side for the worker. From what we know today, we can no longer accept without question the view that a state controlled economy is necessary precisely because of its social qualities, particularly as we must point out that the only real success achieved (i. e. the removal of unemployment) is an aim which can and will also be pursued under a free economy – as we have seen in countries applying such systems. So, on the one hand, we have potential advantages of state control: on the other, an abundance of real disadvantages for the worker as consumer and producer of goods. Hence, he is well advised to view the promises of a centrally directed economy with scepticism.

Situation of other Sections of the Population in a Centrally Controlled Economy

On the one hand, we have those already integrated in the labour force: on the other, the army of refugees waiting to be reintegrated. Whether they will get compensation for their losses of property remains to be seen. The meagre results achieved by the present system of economic control leaves them with little help of finding substantial compensation on the same scale as that offered by the full range of welfare available under a market system. But what matters are not the claims accruing from the past. All who are fully capable of working should turn their thoughts not so much to such claims as to the possibility of finding a suitable job again in a flourishing economy. The question about the type of economic system in which such hopes can be fulfilled applies not only to the refugees but to all who wish to have a real chance of becoming self-employed and achieving success. One of the principal techniques used in a planned economy is to treat jobs and managerial positions as sinecures. It involves a system of working-conditions, prohibitions and obstructions which suggest that a state-directed economy is quite unsuited to the great task of coping with the labour-reintegration process. The present state of affairs cannot be considered a solution. Its main features are a sham employment situation and a loss of productivity. In actual fact, the position is such that it is no longer possible to keep the demand for labour flexible except with regard to the most primitive and lowest paid jobs. We see this in Germany, where the labour exchanges are resorting to all imaginable means to find workers in this category,

whilst there is no demand for skilled labour – except in certain trades. We can also see this abroad in the discussion with regard to the repatriation of German prisoners of war. It can reasonably be doubted whether the forces of economic control are sufficient for regrouping on such a massive scale. It is true that a state-directed economy has many means at its disposal to check developments, but it has not up to now shown the ability to allow personal economic initiative a real opportunity to develop. Once the surplus money has been used up, the sharp contrast will be obvious.

It is to be feared that the system of central controls will not be able to answer the question as to what is to be done with those people who find no jobs in industry, trades, etc. The market economy has shown ways of coping with this problem, whereas a state-controlled economy has so far merely tried to conceal its own inability. If we look at the large-scale urban development plans for integrating refugees – for instance the Three-Phase Plan in Hamburg – it is surprising to note the superior manner with which the State determines where refugees shall be forced to work and live. In effect, this is making one group of people carry most of the burden for some of the consequences of the war. The protection offered by state-planning is fictitious. The only true criterion which all those who are to be reintegrated into the labour force apply when assessing the merits of the economic system is, in the final analysis, its ability to expand production. The market economy has proved this ability beyond question. I need only recall the process of industrialization in the 19th century during which a market economy not only managed to absorb an urban population that had grown three times in size, but also the great influx of people from rural districts. This also applies to young people and to the women who now have to enter the labour market. All of them want to have more than just marginal and low paid work; they want to see chances of promotion and not merely to look at closed doors which are a necessary corollary of any authoritarian control-economy. In view of the swelling of our labour force – still of course concealed at the present time – the social problem in this respect is almost identical with that of how private initiative can be developed everywhere so as to enable us to exhaust every possibility for expansion.

As regards those who receive no more than national assistance, their position is in a special sense identical with that of the normal or marginal consumer. All the disadvantages of the normal consumer are shared by the recipient of welfare benefits. By enabling some sections of the population, chosen irrationally and by no means all of them needy, to benefit from the national product as a result of the excessive available purchasing power without being entitled to do so by virtue of their own productive contribution, the state controls we know today have undermined the prospects of providing genuine and lasting assistance to the indigent persons. Under a free market economy, a clearly defined category of people could receive more effective and more substantial assistance.

Germany Needs a Free Market Economy for the Sake of the World Economy

Under a system of state control, the social balance-sheet shows a noticeable deficit in spite of all public propaganda. We cannot end this survey of our social problems without mentioning one last point. In the present situation, the German nation as a whole is at a disadvantage in social terms compared with other nations, and we must ask ourselves in this situation whether state control or free enterprise should be recommended as the more appropriate means of eliminating these disadvantages.

This dubious status of the average consumer reveals itself in two ways: domestically, as a result of the shortage of industrial goods, and in terms of world trade owing to the fact that Germany, in satisfying its food subsidy requirements, has moved into the position of a normal and marginal consumer on the world market. The only reason why we have any chance at all of obtaining food on the world market to help us out of our present emergency

lies in the existence of those overseas territories which still have a market economy and produce surplus goods. The countries with radical collectivist systems have up to now proved incapable of helping in any substantial way to alleviate the distress of the world population.

It should be noted that, whilst goods are produced overseas in accordance with market principles, shipments of grain are controlled by an international machinery which operates the same system of priorities as on the domestic market. The consequence is the same. The normal consumer finds himself in a dubious situation; indeed, he does not even enjoy the opportunity he would have in a market economy to outbid others and force his way into the market. The existing deficits remain without remedy. As regards the supply of fat, for instance, the acuteness of the shortages suffered by the people in Germany in no way stimulates production – which would at least give hope of the shortage being overcome in the future. The same can be said of other food sectors. The highly delicate problem of marginal consumers, both internationally and domestically (and we in Germany fit this description in every respect), consists in the fact that the supply problem faced by the consumer does not produce any remedial action on the part of the control system. Under a market economy, the food shortage in Germany would be counteracted by the boosting of exports, which in turn would generate a certain amount of complementary production in other parts of the world. But at present nothing is happening. Overseas territories have not even had a chance to adapt to German consumer's present needs. Even last year's increase in grain production has done nothing to help the marginal consumer's situation, since the disadvantage he suffers under the present authoritarian control-system cannot be made good. The occupation powers and the German authorities are therefore quite wrong in thinking that Germany's situation will improve if world harvests increase. No matter how bountiful the harvest, we – being the last – will never see our most urgent needs satisfied; and what we do get will amount to no more than charity. As long as the market system has not been restored, the temporary surpluses (such as the large fish catch in the Scandinavian countries) will not lead to trade but, as has already been the case, to a restriction of production. International trade calls for participation by a Germany with a free market economy.

Even in former times, it was argued that the have-nots of the world would only be able to offset their disadvantages by means of economic controls. And in Germany today, it is generally held that our poverty leaves us no freedom in our choice of economic system. The occupation powers subscribed to this view, and even the United States authorities agreed to the introduction of a system of central control, thus acting at variance with their own principles. If Germany currently sees its chances of obtaining adequate supplies through trade jeopardized in spite of excellent world harvests, this is not simply the result of an objective shortage of food but of the international trend towards adopting systems of economic control. This situation can only be changed by immediately allowing Germany to participate in international trade. Germany must provide the market incentives, via exports, for an increase in the production of, say, vegetable and animal fat, or else prices should be increased to reduce the consumption of these commodities and hence the production of soap and paint, for instance. That is the only way in which we can improve our situation.

Precisely on account of its precarious situation, Germany hopes for an early dismantling of the centrally controlled distribution system. It may sound paradoxical to us when we note that the interests of the wealthiest nations and the interests of such an impoverished nation as Germany concur where the world economy is concerned. The United States as the leading producer and Germany as a marginal consumer want trade to be governed by market principles. As long as we remain an object of economic control, the disadvantages suffered in the main by marginal consumers – which are becoming obvious enough even among such privileged countries as Britain and Sweden – will come our way, too.

Let us try to find the link between these general considerations and the decisions we are faced with at present. The state-directed economic system has proved to be a complete failure. The head of the West-German Administration of Economic Affairs has openly admitted that the system is disintegrating. Over the past 15 years, we have had reason to learn from this experience in Germany – an experience which we were forced to endure to the bitter end – and to set about the task of building a new economic order. Such an economic order will not be the outer decoration of the nation's economic life, not merely the frame for a picture awaiting completion. As we can see now, a functioning economic order is the most fundamental economic basis which has to exist if we want to get the economy going at all. If we decide to give up the old structures which were often the result of an indiscriminate approach, then at least the main argument so far propounded for maintaining economic controls is no longer valid i. e. the social supremacy of centrally administered economy. In reality, a state-directed economy involves a whole range of disadvantages in social terms, too. We would therefore be well advised to look for a new system which will harmonize both the social aims of our time and the most fundamental tenets of business practice and the science of political economy.

Such a synthesis can only be achieved by the re-establishment of a genuine market economy. This new market economy must distinguish itself from the liberal market economy of the 19th century which, like the system of central control, is a thing of the past, by virtue of its social objectives. We must build a »Social Market Economy«.

Let me single out just one question of topical significance from among all those which relate to the construction of such an economic order: what prospects and possibilities exist at present for creating a »Social Market Economy«? As regards the prospects quite generally, those who can only see Germany rebuilding its economy within a system of state control should examine more closely what has been happening in Europe in the past two years. Let us leave aside the tremendous increase in productivity in the United States, which has indisputably been achieved by market methods. We have perhaps grown far too accustomed to regarding this American example as too much of an exception for it to be followed in Europe, let alone Germany. Those who harbour doubts will perhaps confine the rapid reconstruction of Belgium and Switzerland in the two postwar years to that group of countries currently living on the sunny side of economic life in Europe. Italy appears to me to provide an even better example as a basis for examining the problems entailed in the social market economy. In spite of its lack of raw materials, the destruction caused by the war, the political unrest and a high rate of inflation, Italy has managed to raise industrial production to about 80 per cent of its pre-war level. This example of a country, which was by no means in a privileged position at the end of the War, has demonstrated the tremendous re-organizing force of a market economy. Critics of this development point to the huge disparities in income levels prevailing in Italy at the present time. Although one gains the impression when comparing prices that this is exaggerated, those disparities do seem to exist. But anyone who knows Italy from former times will concede that social differences have always been very pronounced in that country. To expect the market economy to overcome in only 15 years the aftermath of centuries of historic development is to ask the impossible.

The Italian example shows us most instructively what the free market principle represents: a means of getting production moving and at speed. Germany has demonstrated this energy once before, i. e. when the economy moved from inflation in 1923 to stability in 1924/25. During that period, nearly all production figures for primary and finished products increased twofold and more. This was a sign that the preceding low level of production did not result from a lack of raw materials, but from market disturbances. And the Italian example also shows us that it is necessary to organize a free market economy (which is a neutral system) on the basis of economic co-operation, to include social safeguards, and to

develop it into a truly social order. Only in this way will it in my opinion be possible to find a way out of the chaos – a solution which will have to be sought as quickly as possible because we must remember that the diagnosis provided by champions of the market economy one and a half years ago, namely that industry is not starting up but phasing out, still holds true today. It would be a mistake to assume that we have reached rock bottom, the point where the economic situation cannot grow worse. It definitely can get worse. If we deprived companies of the requisite freedom of action by not allowing them a certain amount of compensation, the decline in the manufacturing sector would continue. And the danger would be even greater if total controls were introduced in agriculture: what little interest farmers still retain would disappear altogether.

The aim must be to establish a market economy tempered by social safeguards which are consistent with free-market principles. Rather than distort economic interrelationships by fixing prices and injecting purchasing power, it would be better to adjust undesirable disparities in incomes via a clearly defined income tax system. A social market economy established on this basis could assume a more radical or a more conservative form, depending on the political intentions of the Government. By keeping the trading system intact and at the same time achieving a high level of productivity by providing adequate safeguards for free enterprise, such a market economy stays within the range of what is feasible and avoids those almost tragi-comic situations arising from a system of control which links ever growing promises of social benefits with a constantly falling standard of living.

A social market economy naturally presupposes the development of a legal framework for the economy which does justice to all involved in the economic process. Indeed, it is the advocates of the market economy who have been calling for just such a framework for decades. I recall in this context the works of Franz Böhm. It is quite consistent with market-economy principles to introduce certain safeguards along the lines of the American anti-trust laws to prevent any one-sided accumulation of economic power. Only under such a social market economy will companies and trade unions possess the scope which they need for genuine, free negotiations leading to collective agreements, without these being distorted by the intervention of the State. I intimated earlier that anticyclical and employment policy was first developed along systematic and scientific lines by people who uphold market economy principles. Such policies will have to be kept within the framework of the market economy. But once stripped of certain excesses associated with state controls, they will certainly have their place in a future market system.

It would be a fundamental mistake to think that supporting the market economy is the same as adopting a passive attitude and allowing things to run their course. What we need is an all-embracing system which unites intellectual and personal freedom with social security. It is quite possible to merge both aims, though not in a state-directed economy, which ultimately casts doubts even on its social intentions as a result of economic failure. A free market economy is, however, amenable to such a synthesis.

Two completely different arguments are currently put forward in opposition to the view that substantial objections must be raised to economic controls on both economic and social ground. One of these points out that the trend towards ever stronger state controls is a dictate of history, which takes us further and further away from a market economy whether we like it or not. It would take up too much space to go into this argument in detail, but economic research in recent decades has examined such supposed laws of development in great depth and proved that they are non-existent. Although there has been a growing trend towards economic control, this has not been because of any economic inevitability such as the priority of fixed costs, but because the people, in their belief (indeed their illusion) that everything has to be brought back on course by means of state control, actually influence the trend in this direction.

This brings us to a second point which deserves greater attention. Today, it is argued that there seems very little point in verifying the economic errors of the central system because it

is allegedly not an economic question but in the final analysis one of power and Weltanschauung; and, moreover, economic reason cannot possibly prevail in the face of a blind ideological belief in state control. There is some truth in this. The expectation that all problems can only be resolved by increasing state power and introducing more obligations and regulations undoubtedly stems from irrational sources.

There is indeed such a thing as an irrational modern faith which cannot easily be countered by objective arguments. However, I do not think it necessary to leave it at that and abandon the matter in a mood of sad resignation, because there are indeed a number of indications that the force of this irrational belief is dwindling.

As economic methods have for decades been regarded all too much in terms of strength and ideology, wide sections of the population are now beginning to realize how much the down-to-earth and primary objective of all economic management has suffered under this approach. The purpose of the economy must surely be to provide the necessary food, fuel, household goods, clothing, etc. and not to expand economic power. It was an abuse of economic resources if, in the past, the economic system placed economic power in the hands of certain monopolies. We know that the exercise of such power by a section of the workforce or of government bureaucracy would be no less dubious. In recent years, people have lost sight of the real criterion for judging the value of an economy. The yardstick is not whether it is purely and perfectly planned but whether and to what extent — to put it in quite sober and material terms — it provides us with the necessary consumer goods. Unfortunately, we have not yet reached the stage where, considering the economy as a whole, everybody acknowledges the great extent to which the exercise of power distorts the economic picture.

And yet I feel that this irrational belief, which currently dominates the system of state control in Germany and in other countries, has passed its historical climax. Now that the dangerous nature of all secular surrogates of religion and faith (whether they concern race, the class struggle, or the omnipotence of the State) stand clearly revealed, large number of people, especially the young, appear to be disillusioned. That gives us good reason to hope there will be a change for the better. How quickly the faith of the broad mass of the population in the system of state control has disappeared may be seen in the recent disturbances in France, where huge crowds of people began to demolish the economic administration offices and where a prefect who had issued a compulsory order was forced to get up and cancel it over the microphone. It has also been illustrated by the determination of French textile traders to lift government controls of their own accord.

The discussion about the question of nationalization in Germany also shows clearly enough that a search is being made for new departures and that people are beginning to doubt the methods used so far. We shall, I feel, have every reason to be confident that the better arguments in favour of a market economy will also prevail over a general faith in the system of state control. This will of course require us to enter into an urgently necessary dialogue with all sections of the population concerned with social policy in order to illustrate the importance of a market economy and to make people aware that it constitutes a genuine economic order which involves more than a conscience-stricken legalization of imagined economic abuses. The change of attitude in the past six months has surely confirmed this optimism, for there has been a growing willingness in many quarters to acknowledge the validity of a market economy. Moreover, this is not a matter which can be decided in Germany alone. Germany's integration into the world economy and into a genuinely functioning export trade will, whether we like it or not, constantly force us into a market economy framework. If we speak of the exigencies of development, these are matters which will not be decided by Germany but by the present confrontation on the underlying principles of the world economy. Unfortunately, we are at present no more than uninvolved spectators. However, it will be in our own interest, seeing that we wish to become involved again in international trade, to draw the necessary inferences for our domestic economic policy. What we need is a more realistic approach to economic policy which, under a social

market economy, will enable us more effectively to cope with our present-day problems without jeopardizing the fundamental aims of industry. I see little point in arguing too much about the name of our future economic order, but it is important to have a clear view of what should be done immediately in the present situation. Even those who cannot definitively support the idea of a market economy have to accept certain facts which are directly applicable to the present situation. First of all, it must be admitted that Germany's current economic difficulties cannot possibly be overcome by means of even more extensive government power or by appeals to the nation's moral conscience. Any economic policy that wants to be taken seriously must start from the reality of the situation.

It is a fundamental error on the part of the occupying powers and of the Administration of Economic Affairs to declare that our present difficulties have arisen because we have a «completely inadequate incorporation of agricultural production and available industrial products». The present economic chaos is not due to the failure of agriculture or trade and industry (and thus in the final analysis to people failing to meet the requirements of the state-directed system) but to the fact that the system itself has failed to serve the people and proved incapable of adjusting to the needs and realities of industry. It is not the psychology of the people which needs to be changed (which would hardly be possible within the next few years in view of the abortive attempts to do so over the last few thousand years), but the control system itself. The point has clearly been reached at which any further government intervention would result in the total collapse of the economy. Even now, we do not deny that the central system possesses this negative power. It is also necessary, not only in word but also by deed, to provide a certain amount of freedom for economic operations whilst maintaining all the other safeguards. Whatever the actual shape of the system, we shall inevitably have to take a step towards market freedom.

No-one is considering dispensing with all economic controls overnight as ill-willed people are constantly accusing the champions of the market economy of wanting to do. But what should be done as a first step, and preferably today rather than tomorrow, is to decontrol some factors of the market with certain basic quotas being temporarily maintained on social grounds. In order at least to make a transition, I have suggested that the market be divided for this purpose. Both in agriculture and manufacturing industry, there would be basic production which would continue on the basis of stable data for the time-being and a free market which would account for a certain proportion of current production. Whether this free market should immediately have a completely free pricing system or whether one should be content for a start to give companies a legal chance to operate in barter trade and compensation agreements is a question of tactics. There is much in favour of legalizing and demarcating such compensatory business inasmuch as it comes from extra production. This would benefit not only the free market itself but also the «quota markets», whose output is increasingly jeopardized by the decline of the control system. The advantage of such a legitimate, free possibility of compensation is obvious. It is the only way to halt the continuing operational decline. The involvement of wholesale trading firms, which may possibly be able to fix their own exchange values, would bring considerable mobility into the compensation business. But every step towards a market economy must be accompanied by certain social safeguards. This would even be possible in the transitional stage if such compensatory production were initially restricted to two purposes. For the time being, it should only be permitted as a means of keeping companies operating smoothly, albeit not for investment; and it should be permissible for social purposes, especially for wage-incentive systems and factory canteens. This latter requirement is in my view necessary on social grounds. But all these measures can only be regarded as provisional steps on the path towards achieving a genuine market economy. Any kind of compensatory production benefits a certain category of establishment, worker, and salaried employee. As a result, the marginal consumer finds himself in ever greater difficulty. To him, compensation is only tolerable if it furnishes a direct means of increasing production, although it should be

remembered that any increase in production within a state-controlled economy is of little use to the marginal consumer. What I said earlier about Germany's position in the world economy also applies to him. One can only freely become a consumer by becoming a producer within the system of world trade or within the national economy.

At the present time, it is otiose to speak of introducing more compulsion or of applying ultimate principles at some time in the future. The critical condition of our economy calls for realistic action and the removal of certain controls to motivate the people again. Every step towards a market system which improves the supply situation must be seen as a social advantage. But beyond that, we must build safeguards into the new system to ensure a fair balance between economic efficiency and social requirements.

In this synthesis lies the fate of our civilization. We simply have to be clear in our minds that, in a deeper sense, we have no freedom at all in our choice of economic system. Without the high rate of production achieved under a free market at the end of the 19th century and at the beginning of the 20th, the tremendous growth of the world population and the concomitant raising of their standard of living would not have been conceivable. It is therefore simply not possible to replace this system, which is the prerequisite for the present size of our population, by one with a lower degree of productivity. The upshot would be the pauperization of millions of people. There are already signs of a brewing storm, but the old market system has still managed to produce that bit extra which has at least warded off the worst. But the dangerous experiment with dubious economic systems cannot be continued in an overcrowded Europe. One almost gains the impression that those in positions of responsibility no longer grasp the significance of the organizational principles which gave Europe its leading position. One of the most dangerous mistakes is the assumption that this threat to life is the sacrifice which has to be made in order to achieve social betterment. The opposite is true. At least now, where a specific system is obviously at the end of its tether, all people of good-will should unite to create a common foundation on which we can rebuild the German economy. The ideals of freedom and social justice can indeed be linked together on the foundation of the market economy. We can calmly await the problems of surplus which a free market economy has often had to cope with in the past. We have the means to master them.

If we were not so afraid of what happened to Goethe's apprentice sorcerer, we would only need to invoke the spirits of a planned economy, who are followed by shortages just as invariably as they are followed by their own shadows. But there are also less dubious means under a free market economy of checking surpluses. Why, then, should we not entrust the urgently necessary reconstruction of our economy to a system which, albeit modest in its promises, has proved its ability to produce a genuine peacetime economy rapidly and seemingly without difficulty after years of destruction?

The Functions and Limits of Central Economic Administration

Ludwig Erhard

1947

The setting up of central administrative bodies as a transitional solution and temporary expedient prior to the establishment of a single German economic unit invariably prompts the question as to whether an integration of economic forces presupposes the application of different principles to those valid for the rest of public administration and for national policy-making. We can frame the question differently. Will the federal structure of a new Germany (such as is desired by the majority of the German people) suffice for the resolving of our economic problems and, if not, does the German economy definitely need a central administration irrespective of the principles underlying the political arrangement of affairs? Despite agreement on the prime goal of achieving a maximum level of quality and performance in German trade and industry, opinions differ on the advisability of the procedures and principles to be adopted. Perhaps we should begin by shedding some light on the various implications.

Naturally, there is no denying the fact that a larger market permits a more rational use of productive resources. But it seems doubtful – and indeed decidedly fallacious – under a smoothly functioning system of inter-state economic relations to claim that this principle of business efficiency should only be valid if and when the economic area in question is subject to central controls. In the final analysis, that always implies political controls. If the criticized thesis were in fact true, it would confer upon nation-states a wide measure of moral justification and a socio-economic basis for pursuing imperialist economic goals. By contrast, small countries would lose the capacity to shape their economies along rational lines and to hold their own in competition. We know from past experience, however, that small nations such as Switzerland or Denmark have adopted a profound measure of specialization and attained a high all-round standard of living. Let us cite another example. The breaking-up of the British Empire in political and administrative terms has certainly not resulted in any relaxation of economic ties or uniform economic objectives.

This line of argument is not intended to show that the economic objective of amalgamating

the two zones of occupation could have been equally well achieved in some other way. On the contrary, this course of action impressed itself upon us as the only promising internal solution for surmounting our economic troubles. I trust, therefore, that my words will not be misinterpreted when I say that neither geographical constraints nor the demand for centralized political direction of this economic area in themselves would have furnished sufficient reason for a fusion of the two occupation zones. If we wish to put the problem in its correct perspective in terms of time and circumstances, we must above all take into account the following fact. Even though the smallest nation-state may prove able to organize its economy in a rational manner, serious disturbances are bound to occur in a historically evolved organism like the German economy if it is split up into isolated sections, particularly at a time of grave economic setbacks, with the attendant obstruction and severance of the many thousands of personal and material links and ramifications. This becomes especially disadvantageous when no opportunity presents itself for offsetting the abruptly supervening structural reversal by adjustments in the pattern of foreign trade. Hence, the demand for the establishment of German economic unity constitutes a social and economic necessity not because the individual zones are too small in superficial area, but because they make up a single organic and functional entity incapable in people's minds of factual or theoretical subdivision. The administration of a single market naturally presupposes the binding recognition by everyone of certain legal rules (such as those obtaining in trade and company law) as well as respect for certain economic norms (such as conduct and customs in trade and industry, for example in the field of competition). There is also a requisite commitment to the application of the same practical instruments such as money, measurements etc. Finally, it should be borne in mind that many of today's major activities such as the organization and implementation of foreign trade can only be satisfactorily handled at that higher level. However much all these factors may suggest the need for reuniting the separated parts, agreements of the described kind are not definitively tied to a system of political centralism. In effect, it even remains doubtful whether economic administration need be inspired by the centralist principle in order to fulfil its aims. There is no absolutely valid answer to this question, either.

The more an economy inclines towards central planning and seems willing to prefer government controls to a freer economic system, the more easily the centralist principle will also hold sway in the field of economic administration. Be that as it may, we do not at present have any free discretion in this direction, since social and monetary conditions in themselves indicate the necessity of a tighter planned economy involving the management of all goods. For that reason, it is quite logical that the recent fusion of the two zones of occupation should have been accompanied by the creation of central agencies for trade and industry.

Today, the main task consists in setting up a centralized planning agency for the economy, in guaranteeing an economically rational and socially fair use of production resources and above all in apportioning the national product (i. e. income plus goods) in a fair manner. However, economic administration does not always presuppose a centrally planned economy. As soon as the worst forms of economic distress have been overcome and a greater measure of freedom and competition begins to prevail in economic life, the economic administrative authorities will then be able to concentrate their efforts on the overriding economic objectives and on the supervision of the economic system as a whole. This switch in priorities will fundamentally alter the character and functions of these authorities. Whatever form the political decision may take, it should be stressed that the expression «central economic administration» admits of very different interpretations ranging from total central domination and the control of all aspects of the economy to a looser form of standard-setting and regulative direction. Although the need for a central administration is by no means disavowed in the case of an expanded economic area, there nevertheless remains the question as to whether the thoroughness and scale of administrative activities exercise a positive influence on quality or whether the economic order and in particular the social order

do not in fact essentially depend on other factors and forces, which ought perhaps to remain beyond the ambit of state control.

Reflections of this nature are of great benefit to us today if we are to avert the danger, attendant upon the current necessity to set up a bizonal economic administration, of regarding this pursuit of temporary tasks as a permanent assignment and thus of unjustifiably multiplying bureaucratic institutions. Any administrative centralism which becomes an end in itself and at the same time attempts to take over all levels of executive government violates the spirit of democracy which, unlike autocracy and dictatorship, aspires to a wide dispersion of responsibilities clearly perceptible to the people. Without a centralized administration and its concomitant powers, for example, the deterioration in Germany's economy would never have assumed such pathological proportions. It will not always be easy to find the requisite synthesis and this will always depend on the scale of political demands on the one hand and on the manifest, sociologically necessary influence of political power on economic events on the other.

Let me conclude with the following observations. Political federalism and economic centralism do not form mutually exclusive opposites, just as an economic order, both in principle and in absolute terms, does not need to have any centralist administration of its market. We need only think of the universally desired future regulation of the world's economy to realize that economic problems can be solved by a freely obtained agreement between independent States without any central controls wielded by a single authoritarian agency.

Under the existing economic and social conditions, the establishment of centralized agencies for economic administration of which we have been frankly speaking represents a major step forward along the path leading to the recovery of our economy as well as of our social and political life. But the new economic bodies must be of such design as to forestall attempts at achieving the goal of economic order, either now or in the long run, by exaggerated centralist economic administration, i. e. by an excessively and totally planned economy.

Section II

The Fundamental Decision in Favour of a Social Market Economy

The Programme of Economic Reform

Ludwig Erhard

1948

In all observations, I am naturally guided by a policy which does not simply content itself with attaining a quantitative improvement in the disproportion between the supply of goods and the revealed demand for them, but which sets out to tackle the evil at its roots. Every provision likely to force us by virtue of the persistent, albeit less marked discrepancies to retain the previous form of economic rationing – including the price freeze – as our future economic system and every provision unable to end immediately the nightmare of price-controlled inflation would either make further currency measures inevitable or else perhaps even perpetuate the harm. At any rate, there could be no more talk of future economic policy if such a sombre prospect came true. The problems would remain the same as today's and the measures adopted would prove equally ineffectual. In my categorical rejection of this economic principle, I am not preaching a return to the liberalist economic patterns of historic tradition or the irresponsible buccaneering of past times.

The innate tension between the individual and society can never be overcome by denying and abjuring either the one or the other. Hence, the question always turns on the principles and ways by which man fits into the higher forms of social order without abandoning his true identity. You will note that I said «fits into» and not «submits to». Anyone aware of the constraints inherent in our economic situation as a result of the chaos in currency matters will acknowledge that today's principle may be invoked in its original sense and that it is bound to develop either into freer forms of the market economy or else into absolute totalitarianism. Even though we may not be completely agreed on our goals, the direction which we shall have to take is clear: liberation from a centrally planned economy which compels everyone to shoulder the yoke of a bloated bureaucracy – a development certain to destroy any feeling of responsibility and duty as well as to work und produce, and therefore certain to make rebels of even the most docile citizens in the long run.

However, neither anarchy nor a termite state are appropriate forms of existence for

mankind. Only where freedom and commitment become mandatory law will the State attain the moral justification for speaking and acting on behalf of the people.

In concrete terms, this signifies that we must again give greater scope of action after the Currency Reform to human will and to human effort both in production and in consumption, thus automatically creating openings for competition based on efficiency. Wherever society fears aberrations or dangers from such a development, it may well decide to set limits or to devise rules for them in the shape of social, economic or financial measures. In terms of distress, society may even feel compelled to adopt such measures. However, society cannot suppress and destroy man's most fundamental instinct without impairing humanity itself. The conventional terms such as a «free economy» or a «planned economy» have not been bandied about so much in the dispute between the parties as to become useless for serious debate. The belief that a rational blend of varied governmental measures along the lines described above would not permit any judicious steering of the economy and that farther-reaching action directly committing individual citizens was necessary proved to be one of history's tragic errors. Enough examples have been handed down to us from the past to demonstrate that this kind of economic regulation soon evolves into tutelage, domination and outright oppression. Any system which does not leave completely intact an individual's free choice of occupation and of consumption contravenes human rights and harms the very social classes for whose protection these spurious measures were conceived. Who, for example, would deny today that the present controlled economy – rejected though it may be by all concerned – has brought most suffering to the weak and the poor or that this class of the community entertains the profoundest hate of all for a system which has oppressed and humiliated them.

In order to dispel some of the misgivings felt about current developments, I would add that I by no means feel that it will be possible or even probable to abandon economic controls in their entirety, either in connection with the Currency Reform or immediately afterwards. On the other hand, a very careful examination will have to be undertaken in the light of a future ending of controls so as to establish in what sectors and in what sequence the organizing of the markets can again be left to competition and to free price formation. The dogmatic view that the principle of a free market economy would tend to curtail the wages share of the GNP has not been borne out in practice. On the contrary, it has been refuted. Numerous examples illustrate that the capital component and the formation of own capital in enterprises are higher on an average in a controlled economy than in a competitive economy. In addition, the capital factor has assumed its most important role in state-economies of whatever type.

One fact often overlooked is that the competitive system does not simply apply to certain classes of the community whilst the others have to bear the consequences. There are differences in performance at all levels and there is justification for reflecting this in income, too. In our present great distress, a general increase in work and production will be imperative in order to make sure that, despite all the help received and the efforts made on our behalf by other countries, the German standard of living does not stick at an intolerably low level and that every consignment of goods moving across our borders is not purchased at the price of supreme sacrifices. The material losses in all kinds of physical capital and the ensuing compulsion to replace it, the wear and tear on technical facilities and the antiquated nature of the latter, the weakness of the labour force after many years of privations, the influx of millions of refugees and the obligation to give priority to providing for them, the disadvantageous age structure and ratio between the two sexes in Germany's population, the protracted severance of the markets from the rest of the world – all these negative factors seem to indicate and indeed prove beyond doubt that only the strongest will to work and produce can elicit enough earning power from our remaining material, mental and emotional resources to safeguard at least a minimum living standard. When we are once more able to calculate normally, these straitened circumstances will reveal how small the remaining scope

is for any differentiation between incomes or living standards and how certain it is that the commitment of which I spoke – irrespective of the economic system in question – will insist on making the social side of economic policy not only a requirement, but even a commandment. Since we are trying with all our strength to overcome our privations, this depersonalizing levelling of society would be a misconceived social ethos. It would help no-one, but in fact harm the whole nation and wreck our chances for a better future.

An economy forced to gauge and compare work output and to place increased productivity at the top of its list of priorities cannot forgo the instruments of price policy. By this, I mean price policy in the broadest sense of the term i. e. embracing within its purview fiscal and tariff policy, wages policy, monetary and credit policy. Here, again, the problem must be seen in relation to the Currency Reform, since the technical operation to correct monetary conditions would remain patchwork unless a really coherent equalization process took place on a new sound basis. The price freeze provided the guise for government policies which were clearly heading for chaos. As the price freeze permitted maladministration and the exploitation of all working people, it may be described as the pioneer of a controlled economy which poisoned the political atmosphere. Our task is not to dilute the price freeze, but to get rid of it altogether. Only in this way can we regain our moral stature. Perhaps we may leave certain restrictions in force for a transitional period in order to avoid social hardships. But there must be no compromises in this field if the dynamic process of the Currency Reform is to be successfully completed. A system of freely fluctuating prices would not even be at variance with a planned economy if the planning authorities were prudent enough to submit to the approval of the market i. e. to the voice of the people. However, free price-setting remains absolutely indispensable if a free exchange of goods with the rest of the world is once more to operate on a sound inter-currency basis.

Only in this light does it seem sensible to embark upon price adjustments for the period leading up to the implementation of the Currency Reform so that the prohibitive subsidies for the public authorities can be discarded after the Currency Reform or at least an in-plant coverage of costs achieved on an average. Fundamentally, an attempt will be made in this approximation of prices to arrive close to the probable market prices. However, a slide-rule cannot determine an economically correct and socially tolerable price. As the capacity is not fully utilized, a determination of prices on this basis of costs would result in excessively high prices. This must not happen, just as an excessively low price must not be allowed to prevail, since such a price cannot cover the costs despite all the efforts made. In this field, we are moving between limits whose absolute level is decisively influenced by wage costs and wage policy. As I am quite convinced after twelve years of price-freezes that all prices in themselves and their ratio to each other must be inaccurate, the new moves – beginning with the prices set for raw materials – can only amount to fairly rough price approximations and wage adjustments. A genuine settlement of this problem – perhaps the most important economic issue of all – will probably not be possible until after the Currency Reform. The relationship between prices and wages will disclose the true picture of our economic and social situation. At the same time, it will enhance our awareness that we must husband our financial resources and that we shall only overcome our distress by more work and more productivity.

It is at the level of economic, social and financial policy that a decision will fall as to participation by individuals and by the various groups of society in our national product. By contrast, any subsequent controls and adjustments by junior officials in charge of allocation are bound to bring about a disruption of the economic order. It seems quite clear in regard to possible economic alternatives that these intrinsically contradictory elements cannot co-exist. We cannot simultaneously steer our standard of living via a wage and income policy as well as via governmental approval or rejection of subscription rights. By the same token, we shall not be able to regulate production after the Currency Reform in terms of goods and services and at the same time in terms of money and credit. Such a situation is bound to

engender discrepancies which will either lead the new system ad absurdum or else require new artificial measures with all their attendant disadvantages. Hence, it will be all the more important after the Currency Reform to achieve genuine coordination between all bodies with economic responsibilities and to provide for regular agreement on the instruments to be employed. Basis consideration ought to be given to the idea of setting up a coordinating body with special responsibilities along the lines of a Monetary Authority – although only after the pros and cons have been carefully examined.

A Complete Reform of the Valid Economic Provisions

Article in the «Handelsblatt»

22 June 1948

The entire body of economic legislation which has hitherto governed trade and industry in the combined American and British Zones of Occupation is to be completely terminated—at least in regard to controls and prices. The measures already taken or else shortly to be announced by the Administrative Council and in particular by the «Administration for the Economy» leave no room for any doubt in this matter. At this stage, we cannot yet go into the details of the highly complex talks which have been taking place during the last few days. But it is now quite clear that a wide measure of agreement has been obtained on the need to annul the bulk of the current legal provisions to coincide with the Currency Reform.

As regards future measures, there still exist differences of opinion. The group whose views have prevailed is determined to put an end to the whole series of economic and price controls once and for all in order to place the Currency Reform on a sound fundament and to promote basic social welfare. The other group favours a more cautious approach to the economic events of the next few weeks and then a gradual relaxation of such controls as are no longer needed. Which of these two approaches may be considered better will depend on the following factors: the scale of individual hoarding of goods; the assessment of the detrimental effects of the foreign trade monopoly; and the chances of curbing these dangers and assessing our credit position. The new laws, to which fresh provisions are being added almost hourly, fall into three parts:

1. The Enabling Law passed by the Economic Council;
2. The decrees on rationing;
3. The price reforms.

At its plenary meeting on 18 June 1948, the Economic Council promulgated the Law on Economic Guidelines after an impassioned debate which lasted well into the night. We have already described the essence of the new legislation on a number of occasions. The Law gives the «administrative directors» the right within the agreed guidelines to introduce rationing and to decontrol the price of commodities, articles and services. As regards rationing, the directors are now bound by the Emergency Controls Law – which was amended during the above-mentioned meeting. In the prices sector, the Administration for the Economy is largely exempt from the provisions of the Prices Act, but it must nevertheless adhere to the guidelines. The responsible director will have the assistance of a supervisory and advisory committee comprising five members of the Economic Council and three members of the Länder Council. The appointment of the committee attracted considerable opposition in the plenary session, even though it wields no power to enter a veto against the director's orders. On the other hand, it can ensure that the Economic Council will deal with the measures in question. Most members of the Economic Council expressed the opinion that the committee should not be accorded the right of veto because the orders and regulations to be issued in the days immediately after the Currency Reform do not admit of any delay if irreparable damage is to be avoided.

Further Rationing of the Main Foodstuffs and Basic Materials

It must be stressed that the guidelines are considered as binding instructions to the administrative authorities. They should not, however, be deemed an obligatory commitment for every citizen in the country, and this point will be of particular significance in practice. The guidelines state that preference should be given to ending rationing rather than to maintaining it, but that the principal foodstuffs and the basic raw materials must continue to be rationed. The following items may be included under ad hoc arrangements: clothing, textiles, shoes and soap. Furthermore, supply instructions and orders to commence or terminate manufacturing may be issued in cases where no rationing exists. Finally, the law provides for a general register of supplies – a departure from the hitherto valid system of individual permits. The guidelines on prices also stipulate that preference should be given to decontrols wherever feasible. However, the prices must be stipulated for the major foodstuffs and raw materials, rents and fares. Only the Economic Council itself can decontrol the prices of farm produce, coal, gas and electricity. The stipulated prices must be maximum prices and all prices (including those which have been decontrolled) must be supervised. Any exploitation of a position of economic power must be punished.

Great importance attaches to the new Article IV, which declares that credit policy must be principally a matter for the «Administration for the Economy» to decide. This provision possesses considerable practical significance, since loans will be of paramount importance in deciding the course taken by the economy. Article V of the guidelines points to the necessity of relaxing the rules on wages and salaries.

The Establishment of Economic Authorities

An amendment to the Emergency Controls Law and the first implementing ordinance to that Law are directly connected with the guidelines. The important feature of the change is that the Administration for the Economy has acquired permission for immediately setting up economic authorities. The latter, consisting of representatives from the whole range of

trade and industry, will operate as a separate legal entity. The new authorities will replace the former supervisory bodies and exercise two main functions:

1. The transmission of the quotas granted to them by the director to the individual entrepreneurs; and
2. The implementation of the requisite activities connected with import and export transactions.

The Administration for the Economy will appoint a representative for each economic authority: he supervises their work and may issue appropriate instructions within the framework of general guidelines. The economic authorities are entitled by law to request and to provide information.

The new legislation also confers the right upon the director to forgo consultations with the special committees prior to the enactment of legal measures. This renunciation of the obligation to consult the committees is subject to a time-limit (31 December 1948). The amending ordinance also gives every director the right to issue detailed orders. In addition to these fundamental laws, the Economic Council also took another look at the controversial price regulations. Finally, it was decided to allow the director to determine the price of gas and electricity. The issue of the controversial regulation on passing on prices for trade and industry was not approved. The importance of this regulation was, however, substantially diminished by the imminent ordinance on decontrolling prices and is probably without any great interest for trade and industry since it has been overtaken by the announcement of the Currency Reform.

Changes in Rationing

The laws on rationing will usher in two sets of changes: the instructions to relax regulations and a great deal of liberalization. Some of the derationing will already have been announced by the time of our going to press inasmuch as this is possible within the framework of the law as it now stands. The remainder will only be introduced when the new laws have been approved by the Länder Council and the Allied and Military Governments. It is expected that provisions will be enacted without delay for textiles, shoes and leather, glass and wooden articles together with a «negative regulation». To the extent that rationing is retained in certain sectors, it is expected that the regulations will be substantially relaxed in comparison with the old situation so that one can hardly speak of rationing any more . . .

The basis of all these provisions is the firm expectation that the extraordinary shortage of money will render impossible any unprofitable production and thus also make rationing superfluous. It should be added that a number of individual items are still controversial in trade and industry such as the derationing of wood.

The End of Price Controls

The new measures are to be set out in a «price liberalization decree», which cannot be issued until the laws themselves have been promulgated. The main points in the decree will be that:

1. A large number of price regulations will remain as they stand;
2. All regulations not named will be annulled; and
3. The chambers of industry and commerce will have to submit regular reports on decontrolled prices.

It is probable that the present prices of all agricultural products and foodstuffs, coal, coke, soap and detergents, electricity and gas, fertilizers, water, petrol, insulin and penicillin will be retained. Iron, pig-iron, rolling-mill and low carbon products will probably remain

subject to controls. The arrangements will also be retained for rents and leasing as well as for imports and exports. Other price controls to be retained are those for: fares, public fees, professional fees and pharmaceuticals. It still seems to be uncertain as to whether the prices of shoes and textiles will be decontrolled. The prices of non-ferrous metals are to be adjusted to accord with world market prices.

The regulations governing public services will remain in force – as will the ordinance on price fixing. Pursuant to the instructions of the Economic Council, a special provision will be issued to prohibit the abuse of undue price rises and to render this liable to severe penalties. The normal range of price formation will not be affected by this – merely any profiteering consciously carried out to exploit shortages. This instruction will have considerable significance in that the officials appointed to supervise prices will now be able to concentrate on a much smaller number of tasks.

The New Facts

Ludwig Erhard

1948

When our official policy switched from that of a controlled economy to a free market economy, we were doing more than merely introducing a circumscribed measure of economic action. We were in fact reshaping the whole fabric of our economic and social life and making a completely new start. We had to cast off the intolerance which leads via bondage of the mind to tyranny and totalitarianism. We had to find a system based on voluntary integration and a sense of responsibility encompassed within an organic economic whole. Instead of the soulless collectivism, which had plunged our nation into mass misery and distress, we turned with relief to a state philosophy based on a true sense of responsibility.

This freedom does not imply freebooting or irresponsibility, but a dedication to the needs of the whole community. The spiritual foundation on which we wish to build up a new economy and a new social order is not a senseless and heartless termite State with complete depersonalization of individual existence, but a naturally evolved State inspired by personal freedom and by an aspiration to higher things. The situation is not so simple as to be described in terms of the apparent dualism between a planned economy on the one hand and a market economy on the other. Both the lessons of history and the conclusions of logical thought indicate that a planned economy invariably leads via diverse interim stages to a regimented economy. On the other hand, it would be a complete misinterpretation to accuse the market economy of having adopted a haphazard approach. It seems to me that these last eight to ten weeks since the Currency Reform have witnessed the drawing up of more plans i. e. more premeditation and provision for the future than all the years of a regimented economy.

The final outcome of a planned economy is always that the individual entrepreneur and consumer have to bow to the wishes of the State or, worse still, to those of an unfeeling bureaucracy. The individual citizen is degraded and humiliated. He is always reminded of the yoke on his shoulder. Our task consists in casting aside this yoke and replacing the

system by a market economy, which has nothing in common with the catchphrases imputed to it – catchphrases which sound as if they stem from the junk-room of old liberalism. The modern type of market economy is not the liberalist buccaneering of bygone ages or the «free interplay of forces» and suchlike. The modern market economy constitutes a social commitment which allows the individual to make his presence felt by assigning supreme importance to individual personality and which ensures due recompense for the effort made.

If we scrutinize the events of the last ten weeks and dispassionately consider with the benefit of hindsight whether our chosen course of action was the right one and whether it involved as many hazards and disturbances as are now attributed to it, then we only have to recall our condition when the Currency Reform took place. That is one point that I would like to make with particular emphasis. A currency reform unaccompanied by a change in economic policy would have been doomed to failure. The prudent reader cannot fail to see that.

Prior to the Currency Reform, the economy could no longer be described as functioning properly. A highly developed and sophisticated market had relapsed into the methods of a primitive barter economy as a result of the monetary chaos and the megalomaniacal insolence of the bureaucrats in our centrally controlled economy. All orderly forms of production had ceased. What remained was a soulless jumble of frightened individuals, devoid of any sense of responsibility, with everyone solely concerned to cling to his or her physical existence. In the meantime, we have overcome this situation. It seems like a miracle – although it was actually only judicious planning in the best sense of the term – that we managed to master this social chaos within a matter of days thanks to a new currency and a resolute shift in economic policy.

Section III

Economic and Socio-Political Orientation

Is the German Economic Policy the Right One?

Wilhelm Röpke

1950

Outside the systematically collectivist world represented by the large-scale Russian market, i. e. outside those countries whose economic system is perfectly clear-cut, a change in economic structure has taken place within the last few decades, albeit in diverse gradations, giving rise to the most profound concern and this at a moment when the gravity of the political situation is forcing the two parts of the world to pit their whole economic strength against each other. The salient features of the change in the economic pattern of the rest of the world, which is neither unequivocally collectivist nor any longer unmistakably capitalist, are vagueness, confusion in guiding principles, lack of a fundamental philosophy, the subversive influence of powerful political and social groups, and growing disintegration. Devoid as they are of any coherent principles making allowance for the old liberalism and the new collectivism, the responsible Western policy-makers for economy, finance and banking seem to be at the mercy of the events of the day; they seem to be left without sufficient protection against any attempts to resolve partial economic problems with improvised measures and against any ideological demagoguery unleashed by full collectivists (or semi- or quarter-collectivists). If we had to illustrate this development by a particularly significant and instructive example, reference could be made to the dangerous instability and imbalance of the British economic system now ensuing with ever greater clarity from the untenable middle course between a liberal and a collectivist economic system. The British set-up thus furnishes a particularly striking and disquieting illustration of the increasingly evident truth that a definite decision must be taken between an expansive and regulative market-economy system on the one hand and a systematically collectivist, centrally planned economy on the other. And if the warning voiced by leading contemporary economists and sociologists about the totalitarian consequences of collectivism does not appear to come true so far in the case of Britain and British democracy remains basically unimpaired, we should nevertheless not overlook the price paid for this completeness of British democracy, i. e. the non-functioning of British collectivism.

The lessons taught by the extreme British example should also be borne in mind by other nations; and West Germany, too, should not fail to take notice. The consequences of such a mixed economic policy in which neither the free-market nor a centrally planned system predominates are as follows:

a) A lack of drive and regular arrangement in all spheres of economic life (output, enterprise, investment, and saving) and a lag in economic performance behind the anticipated results in the light of the available technical and human resources. In short, the danger that the expansive and regulative forces of the market will be curbed without being replaced by at least temporarily expansive and regulative forces of a total and politically ruthless form of statism and centrally planned economy.

b) Functional disturbances in the economic apparatus caused by the divergence between free-market forces on the one hand and strict government directions on the other.

c) The uncertainty about the Government's unpredictable economic policy (thus paralyzing producers' initiative and willingness to take risks) since the rule of consistent and staunch principles has been shaken.

d) The politically exasperating opacity of the economic process, the prevalence of group dominance and the danger of creating an impenetrable jungle of provisions which imply as many privileges as they imply opportunities for legal or illegal enrichment.

Where it is no longer discernible under which kind of economic system we are really living and where there are no simple and firm rules to which economic policy adheres and where wide circles of the population consider themselves to be in the clutches of an arbitrary bureaucracy and of powerful groups tolerated or even fostered by the State, there arises a politically and economically most critical condition in which no country can dwell for a very long time. Even if the East-West conflict were not to force the West to turn its thoughts inexorably to its ideals and to the strength inherent in freedom, the hour would approach more and more rapidly for the West in which an explicit decision would have to be reached on the whole system of economic policy and to bring to a standstill the irresolution and the habit of muddling through from one partial remedy to another. At the same time, we must voice an urgent word of caution about the tendency to build a philosophy on the foundations of a lack of principles and to present economic drift as the superior wisdom of people accepting the given facts of the situation. Those who adhere to this convenient philosophy that the existing conditions cannot really be altered (such as foreign exchange controls, the volume of the government budget, the immobility of wages except in an upward direction and the immobility of interest rates except in a downward direction) should at least have the courage to admit that there is no degree of disintegration which cannot be defended by such an argument. In fact, this philosophy designates precisely the course taken by our economic system in recent decades as it steadily crumbled. Any emphatic call for a homogeneous national economic policy implies that the various segments of this policy (prices, marketing, foreign trade, agriculture, money and banking, the capital market etc) must correlate with each other so as to present a uniform whole rather than various parts reciprocally cancelling each other out. One of the obvious prerequisites for such a homogeneous economic policy is that its central direction must rest with the Minister of Economic Affairs. It seems a cheap argument to designate this demand and its concomitant policy as «doctrinaire». Naturally, economic policy ought to remain flexible in regard to its details and guard against the danger of tarring everything with the same brush. A systematic consistent policy such as that recommended here does not signify that no exceptions should or could be made. Nevertheless, it must at the same time always be dominated by the fear that concessions on the crucial points or even a series of concessions will militate against the overall system which will disrupt it and finally generate further concessions in the direction of government controls. We shall revert to the need for such consistency of policy at a later stage.

The quest for a wide-ranging and comprehensive approach to economic policy calls for profound reflection on matters which transcend the bounds of economics proper. We have

to effect as precise a survey as possible of potential solutions and take stock of all our assets and liabilities. We must realize where this path or the other is taking us and then reach our decision on the basis of general value-judgments the existence of which is to be presumed in the case of a nation unwilling to abandon its substance, its legacy, and its way of life. The decision on the social and economic system must be such as to guarantee maximum economic productivity, stability and justice linked to the maintenance of the essential foundations of our political and social existence: civic freedom and all its implications; the constitutional State based on the rule of law; a democracy not falling prey to the rule of the masses; free speech; a wide spectrum of political parties; a judicious decentralization of administration; respect for all minorities; a well-functioning Parliament; the limiting of the State's activities to the essential issues of communal life; the inviolability of the private individual and of the natural communities of the family, the neighbourhood, district, the Church, profession, and international life.

The economists and sociologists of our age have come to believe with growing conviction in the logical and empirically proven standpoint that basically we only have two options for the regulation and expansion of economy: a free market economy or collectivism (i. e. a centrally planned economy with dirigiste controls). Furthermore, careful thought and practical experience have revealed more and more clearly that only a market economy can really fulfil the given economic postulates. By contrast, collectivism invariably not only mars the ideals of productivity, stability and justice but also presupposes a totalitarian State which destroys the essentials of our political and social existence. If, apart from the austerity of war time conditions, we justly place freedom and justice at the top of our scale of values, we can state the position as follows: even substantial economic sacrifices would be worthwhile on behalf of the supra-economic desiderata of freedom, justice and international harmony. Astonishingly, the very same economic system which secures these supra-economic benefits for us on such a wide scale i. e. the market economy, is also by far the most productive of all known economic structures. Unlike all other types of economy with their inevitably exhausting and continuous struggle against egoistic aspirations, a free market economy can master and refine this most universal and usually most powerful of motives by means of free competition and harness its energy for the service of mankind. At this point, we shall merely state in brief what is of fundamental importance and revert to this subject later with some observations on the requisite qualification and clarification of this line of thought.

The Basic Structure of the West German Economy and Society

Although we can in any case recommend the Federal Republic of Germany to adopt an explicit and uncompromising decision in favour of a free market economy for the fundamental reasons cited above, a number of special circumstances apply to Germany which endow this decision with the character of unavoidable necessity. These are to be found above all in the economic and social structure of the country brought about by the outcome of the war and its aftermath. In its capacity as a densely populated industrial State closely integrated within the world economy, Germany, undivided in pre-war days, had been more and more compelled to safeguard the livelihood and the well-being of its people by applying economic freedom both internally and externally. Moreover, although the arguments adduced even before 1945 by the proponents of a free market economy and by the advocates of international economic freedom had become even more difficult to refute, the factors operating then are now twice as cogent with regard to the West German torso-state. The easiest way to understand the current economic structure of West Germany and the inherent problems is to look at this country as «Greater Belgium». This stresses how much the concentration of a large population within the narrow confines of West Germany forces her

to resolve the problem of viability by methods such as those appropriate to a densely populated, industrialized State such as Belgium. This method represents a combination between an intensive agricultural sector characterized by the proximity of markets and imports of fodder and a highly sophisticated industrial sector able to prevail on world markets because of its extreme elasticity. The task facing industry in Belgium is to make up for the country's highly reduced supplies of food and raw materials.

The comparison with Belgium merely serves to illustrate the nature of the problem of German «viability», the approach which must be adopted to find a solution and to illustrate the fundamental possibility of such a solution. However great the difficulties of attaining a satisfactory solution may be, we must be careful not to commit an error in our reasoning which might from the beginning engender a paralyzing pessimism. This consists in the assumption that West Germany is condemned to non-viability because it has been cut off from its basic farm products in the East as a result of the dismemberment of the nation. It should however be borne in mind that, in so far as West Germany formerly could fall back on the surplus food-production of East Germany, in this case, too, there has always been that very exchange of industrial goods for agricultural produce such as characterizes all national and international trade. Thus, to the extent that this East-West trade has come to an end, the problem for West Germany today lies in the need for her to exchange industrial products for agricultural surpluses from abroad. The fact that such farm surpluses are available in the world today on a more or less adequate scale has not been questioned by any of the experts, even though there is obviously less of a permanent trend in world-farming towards overproduction. Just as the problem was formerly one of reimbursing East German farmers for their produce through a direct or indirect exchange for industrial goods, the issue today is to acquire the agricultural surpluses on world markets by means of German industrial surpluses, which thus directly or indirectly serve to satisfy the suppliers of farm products. In other words, the problem of rendering West Germany economically viable has two strands to it:

- a) An increase in West German farm production up to the market-indicated level of profitability; and
- b) The production of such industrial surplus as is suitable for indirectly or directly purchasing the world's surplus supplies of farm products and raw materials needed by Germany.

Following this clarification of the fundamental implications, we should draw attention to the special nature of the difficulties confronting the Germans:

- a) The rôle of a «Greater Belgium» has been forced upon Germany with the abruptness of a political catastrophe and therefore encumbered her with the enormous burdens and frictions inherent in the sudden necessity of a swift readjustment. This catastrophe with its mutilation of a uniform economic organism has caused severe wounds which can only heal slowly. Even then, there may be complications due to protracted inflammation.

- b) This requisite adaptation to a new situation, together with its calamitous concomitant phenomena, must perforce take place at a time when the world economy has been afflicted by disintegrating trends. In other words, the tasks of «keeping Germany viable» are largely identical with the simultaneous task of re-integrating the world economy.

- c) To the dismemberment of the former uniform German economic organism – in itself an unusually intractable problem for West Germany – must be added the following complication. As of 1st April 1950, about nine million refugees had fled to this torso country (i. e. excluding foreigners), thus causing the population to jump from 39.3 millions in 1939 to approximately 47.8 millions in 1950. At least every fifth West German is a refugee. Apart from the problem of fashioning the West German economy into a viable economic structure, there is now the other predicament of absorbing nearly one fifth of the total population into the productive process.

- d) Unlike Belgium, Germany suffers from an extreme shortage of capital.

The designation of West Germany as «Greater Belgium» also implies that such an objective can only be satisfactorily achieved if a maximum degree of economic freedom, both internally and externally, secures maximum elasticity, adaptability and profitability. Moreover, one must take into account the extreme dependence of the national economy on the vicissitudes of the world market, which are difficult to predict and impossible to control by means of a centrally planned economy. Any insulating or favouring of one particular economic sector necessitates sacrifices and, in the final analysis, renders the almost insuperable problem of adjustment completely impossible. This is equivalent to a coercive policy, a fact we should well bear in mind in all sectors of German economic policy including agriculture.

Other circumstances which widely constrain an overall economic decision in West Germany are:

a) The only recently overcome experience of collectivism, undergone by the German people for more than a decade and resulting in an outcome clearly destined to deter from any further wish for repetition. At least, this experience has demolished the psychological and moral prerequisites for any attempt to repeat the experiment – in whatever form and on whatever scale.

b) The extreme sensitiveness of a nation – probably more familiar with the effects of inflation in all its manifest or concealed forms than any other country – towards an economic policy likely, even remotely, to jeopardize the trust in the validity of monetary and credit policy, because it is not inspired by market-economy principles and tempted by questionable aspirations to «full employment».

From Collectivism («accumulated inflation») to the Free Market Economy

The representatives of collectivism and opponents to a market economy still persist in their attempts to interpret the unpropitious lessons taught them by the success of German economic policy since the Great Reform of 1948 in such a way as to suggest that the undeniable and impressive upward trend of the German economy must be credited to the currency reform, but not to the simultaneous dismantling of the collectivist economic system. This point of view is so fundamentally wrong that a few words will suffice to refute it. In fact, the Great Reform of 20th June 1948 consisted in both, currency and economic reform, which permitted the creation of a free market as quickly as possible and in as many sectors as possible in replacement of the fallacious system of dictated prices and replaced central-government orders by free enterprise. But it is an incomprehensible distortion of the true facts and a failure to recognize intrinsic economic implications if one depicts the currency reform as being more important or as the solely effective part of the overall reform. In order to arrive at the true facts, one has to bear in mind that the grave affliction besetting the German economy at the time was «accumulated inflation», i. e. a mixture of inflationary pressure and government controls leading to the dominance of fictitious dictated figures and finally depriving the whole of economic life not only of any direction but also of its main expansive forces. The outcome was disorder and paralysis in every field. Such a diagnosis of this affliction clearly called for an appropriate therapy. This could only consist on the one hand in removing inflationary pressure and government controls (thus resulting in the described disorder and paralysis) and on the other hand in re-establishing a well-functioning and free-price mechanism. The Currency Reform realized one of the two aims and economic reform, i. e. the restoration of a market-economy, the other aim. Any attempt to confine the efforts to a currency reform whilst retaining a centrally controlled economy would have preserved the underlying source of the paralysis and disorder, i. e. the impossibility of the functioning of the price mechanism and the domination of the bureaucrats. The correctness of this proposition was demonstrated in the French Zone and

above all in the Soviet Zone of Occupation, where the reforms were restricted to currency in the manner advocated by the current adherents of collectivism as the sole reason for economic recovery. Both cases clearly illustrated the failure of this restriction to a currency reform to bring about the rapid recovery which had taken place with such surprising celerity in the United Economic Territory («Bizonia») thanks to the latter's comprehensive range of reforms. Whereas the French Zone soon found itself compelled by the impact of events to abolish central controls in order to catch up with the rest of the country, the Soviet Zone persisted in its old policy and produced results which no West German representative of collectivism can possibly gloss over. The extraordinary way in which the rôle of the currency reform is exaggerated with regard to the recovery of the West German economy may be seen from the following theoretical consideration. In an extreme case, the country could have managed without it if political conditions had permitted the transition to a market economy in such a manner as to give free rein to prices without reducing currency values and thus to convert accumulated inflation into a form of cushioned, stabilized and open inflation. The fact that, in contrast to other countries like Italy and France, there was virtually no such theoretical possibility in West Germany does not alter the fact that restoring the German economy to health could not possibly have materialized without a reform in the economic system (by re-establishing the market economy). By the same token, however, this might well have happened without a simultaneous currency reform.

The credit due to *Professor Erhard*, at the time Director for Economic Affairs and now Federal Minister of Economics, for the economic policy underlying the reinstatement of a free market economy is thus all the greater. Moreover, the proof furnished for the superiority of a market economy over collectivism seems all the more impressive in the light of the remarkable recovery in the West German economy since the Reform. Even the most obdurate detractor of market economy must acknowledge in terms of the situation it convincingly overcame that this system has been a tremendous success and has demonstrated the superiority of an economic principle in a manner which can only be described as unparalleled in history. Whether one takes the production figures, the level of turnover, transport statistics, the quality of goods, the reconstruction of bombed cities or the average standard of living, the difference between then and now has become so enormous that foreigners returning to Germany after an interval of several years speak of an «economic miracle». That we shall also have to emphasize in the present memorandum goals not yet attained or unresolved problems does not derogate from this achievement. But as so many people are inclined today to take our achievements for granted and to direct all attention to the as yet unresolved problems of German economic policy, it devolves upon the impartial observer in particular to recall the remarkable performance of West Germany's economic policy-makers and of the German people as a whole: their undiminished energies were harnessed by this economic policy and they can claim that their achievements have assumed truly historic proportions. It should, however, also be stressed that the unique act of carrying through a currency reform and abolishing central controls was not enough in itself, but that the present situation springs from a long-established and patient policy, flexible enough to adapt itself to the given situations and adroit enough to resolve emerging problems. It is a policy which not only had to assert itself in the face of massive criticism from the Germans themselves but also from the Allies – a policy which, as we can now say retrospectively, has usually proved to be correct because it pursued the consistent and clear-cut objective of establishing a free market economy. This policy also had to face difficulties, some avoidable and others unavoidable, because of the somewhat questionable manner in which the currency reform was conceived and implemented.

It is only fair to stress a further circumstance which does great credit to the German people and to the German government – a feature that has hitherto failed to elicit due acknowledgment. I refer to the fact that an impoverished, demoralized and proletarianized people – virtually stripped of their national existence as the Germans were after 1945 – could hardly

have been expected to embrace a middle-of-the-road policy characterized by great moderation. It would have been quite understandable if a nation in this plight had resorted to desperate and ill-considered radical measures in economic and social policy. These circumstances make it all the more remarkable that the Federal German Government, inspired by a democratic mandate and a wide measure of support among the German people, opted for freedom and for a patient advance along a safe path, thereby setting an example noted throughout the whole world, whilst simultaneously arousing displeasure and constant misinterpretation among the adherents of collectivism. It is probably no exaggeration to claim that West German policy has been inhibited on more than one occasion by criticism and resistance of one or the other of the Occupation Powers, unable for ideological reasons to subscribe in full to the liberal ideas of the German Minister of Economics. Any fair-minded overall assessment of German economic policy in recent years cannot pass over in silence either these external restraints or the manner and the scale of the dismantlement of industrial plants. Such factors conduced in a superfluous manner to rendering the difficulties of German economic policy even more onerous.

The Nature and Limits of a Free Market Economy

It is essential for a free-market system that, instead of regulating the economic process through the plan and the orders of central authorities, preference is given to freely fluctuating prices. Such a market economy assigns to these prices moving up and down, pursuant to supply and demand, the dual function of solving the manifold problems of economic regulation and of supplying the economic process with the requisite impulse needed to obtain optimal production. (The problems of economic regulation include the selection of the goods to be produced, the determination of the quantity of these goods to be produced, the system and the location of production, the distribution of manufactures, the allocation of productive forces among the various categories of consumption and an even regulation of the economic process etc). We assume that the reader is familiar with the fallacy of criticizing such a self-regulated market economy as a disjointed and chaotic phenomenon when measured against a collectivist planned economy. In fact, trained economists accept as an elementary truth that a market economy represents a system of economic regulation which should not simply be shown as an alternative to a centrally planned economic system, based on government orders; indeed, as mature reflection and past experience have proved with ever greater conviction, it is so superior as a regulative arrangement to the collectivist system as to justify doubts whether the enormous range of regulative problems in a modern economy can be solved in any other way! This even holds true if one accepts the forbidding political assumptions under which any collectivist economic system can solely be kept functioning, however badly.

Although a fundamental decision in favour of a free market economy suggests itself as the regulative system pure and simple, equal importance must also be attached to the essential conditions needed for a market economy to carry out its regulating function as well as to the limits of such an economy even in optimal circumstances. The prime essential for a well arranged and smoothly working market economy is that it must constitute a genuinely free competitive system, i. e. one that insists on uniform starting conditions in the struggle for the best performance (competition based on efficiency) and which excludes any limiting or squashing of competition (monopolistic system). Similar to a monopoly is the policy of granting subsidies, which afford advantages to a number of producers at the expense of all other producers. This can only be described as a fundamental distortion of any true competition based on efficiency and solely admissible in extreme and exceptional circumstances where overriding reasons point to the wisdom of such a course of action. Any

complete understanding of the purpose of a free and socially equitable market economy must proceed from the realization that it occurs in its most ideal form when every producer of goods and services, every farmer and craftsman, every manufacturer and merchant, every labourer and office employee, every banker and saver etc. receives as much as is necessary to induce him to provide this performance as long as the market demands it – no less and no more. That provides the sole possibility of attaining a productive, orderly, fair and optimally non-disrupted economic system. Only this method can guarantee that degree of mobility of prices and costs without which the market forfeits its ability to adjust flexibly to continuously changing economic conditions. It must also be clearly stated that monopolistic disturbances in a market economy also include those trade-union policies which, as historic examples have demonstrated, may result in the unions obtaining a disquieting degree of monopolistic power. This observation is particularly important since only a few people venture to speak out on such matters.

If a market economy presumes the existence of free competition as a matter of principle, it must nevertheless permit sufficient scope for justifiable and judicious measures in certain defined situations where insistence on the principle of non-interference would appear doctrinaire. But if an appeal for government help is made in such individual cases because of a general emergency (a recession) or a specific emergency (e. g. in the farming sector) and the need for a strict and impartial examination of the application emerges, then three central points must be observed:

a) Priority should be given, in the event of official action being necessary, to such measures as do not interfere with the price mechanism (but merely alter the «data» for price formation) and in conformity with the market economy rather than militating against it. The latter situation occurs, for example, when the fixing of a maximum price sets aside the price mechanism and therefore assumes a collectivist character. This distinction between conforming and non-conforming interference on the part of the authorities may normally be effected with the maximum degree of theoretical stringency and therefore applied with the desirable practical consistency. Otherwise, there might be a danger of opening the door to collectivism by adopting non-conforming measures.

b) Any government interference ought to proceed in line with the principle that it should, if possible, not serve to maintain an outdated concept whose preservation would in the final analysis prove to be untenable or else only feasible at the expense of growing sacrifices (in the form of maintenance subsidies). Such measures are all the more justifiable, the more they aim at merely facilitating the requisite adjustment of an economic sector to a new set of circumstances (adaptation grants).

c) Deviations from the golden rule of avoiding collectivist intervention and of giving priority to measures in conformity with a free market economy are all the more dangerous, the more they relate to those sectors of economic life which may be designated as vital nerve centres (unlike peripheral areas where a deviation from the market economy will not generate any poisoning of the system by collectivist diseases). The vital spheres of economic life which have to be kept free of, or else freed from, collectivist interference – since the remaining part of the economy would otherwise be forced along the path of collectivism – are above all foreign trade, the foreign exchange market, and the capital market in the widest sense of the term in that it collects and allocates monetary capital between individual investments. An economic system with a collectivist foreign exchange market (foreign currency controls) or a collectivist capital market (capital procurement through various forms of forced saving and government control of capital uses accompanied by the annulment of the regulative function of interest payments) will in the long run become a collectivist economic system for all sectors. On the other hand, there are other sectors such as housing where a suspension of market-economy principles does not generate any direct consequences for the economic system as a whole, however questionable it may be in other respects.

d) Irrespective of the form which official action assumes, there does exist a maximum level in the economy as a whole beyond which one cannot go without reaching a critical point causing serious disturbances to the whole economic system. This holds particularly true as regards those sensitive arrangements for the future dependent on personal trust (saving and investment) which, from that moment, begin to fail and to create grave disequilibria in the economy. At that juncture, the economic system finds itself more and more in a predicament in which neither the repressed market economy nor the only partially prevailing collectivist economy can bring about the regulation of the economy. It then becomes imperative either to restore the workability of the market economy by dint of liberating measures or else to establish a National-Socialist or a Communist type of collectivism as the prevailing system with a concomitant acceptance of all political and cultural consequences. It will be recalled that this critical point in the economic policy of the Third Reich was reached about the year 1936 and then overcome by the fatal decision in favour of total collectivism. At the same time, France decided on the opposite solution of reviving its market economy after the abortive experiment of the Popular Front. The difficulties encountered in *Roosevelt's* New Deal before World War II may probably be explained within the context of the critical point then reached by the United States when the Government failed to make a firm decision either in favour of a systematic market economy or a systematic collectivist economy until the outbreak of War ended this situation. As regards the present-day position in the West German economy, serious thought should be given to the point that many of the current economic disturbances may be explained by the overburdening of a fundamental market-economy system with alien (i. e. collectivist) elements hitherto resistant to elimination. Hence, we must take good care in West Germany not to blame the market economy for distortions and deadlocks actually caused by the incompleteness of our system. There will be an opportunity at a later stage to revert to this point in another context.

e) Another ceiling to Government measures arises from the fact that these measures invariably represent the granting of favours to certain people at the expense of others so that such action can only form a circumspectly and even reluctantly granted exception and never the rule. Every generalization is a highly dangerous abuse which, like the *Ancien Régime*, renders more and more intolerable the burden placed upon the small number of non-privileged persons, usually including above all the export industry, exposed to free competition on the world market. This situation creates more and more entrepreneurs in need of help and infects previously healthy sectors of the economy until an economically, politically, and socially untenable situation arises in which everyone is living at somebody else's expense, consequently undermining self-responsibility and initiative. The inevitable and tragic outcome of all this is an overburdened budget, paralysis of the productive process and a continuous depreciation of the currency as the *ultima ratio regum*.

A further obstacle to the attainment of a true market economy may be seen in the following circumstance. An economic system based on freely fluctuating prices, competition, private property and self-reliant entrepreneurs does not seem feasible in the long run unless certain reforms are simultaneously implemented in order to bring about a fundamental change in the sociological bases (that is to say: by individualizing society and by deproletarianization). These reforms should simultaneously satisfy the elementary need for acceptance and acknowledgment of the human personality, free development, security, personal property and an adequate arrangement of affairs. The recommended measures concern above all the promotion of economic and social decentralization along the lines of a practical dispersion of small and medium-sized enterprise, a judicious distribution of the population between town and country as well as between industry and farming, a dispersion of big industries and the promotion of small-scale property owned by the broad masses of the population. To these must be added any other circumstances which promote the settling-down process of today's «urban and industrial nomads». The desirable goal would consist in

eliminating the proletariat in the sense of a free class of earners of short-term wages and in creating a new class of workers who become fully fledged guarantors of a society of free citizens by virtue of their property and reserves, their status in nature and the community, their sense of co-responsibility and of intrinsically rational work. Within this context, we can also recognize the justifiable nucleus of aspirations which in Germany have been given the questionable form of demanding the right of «co-determination».

It would perhaps help to bring about an approximation of the opposing camps if one were to proceed from the recognition that the operations of a large-scale modern enterprise involve some of the most difficult human and social problems of our civilization – problems which will repeatedly give cause for the most dangerous of demagogic demands unless they are resolved in an economically reasonable manner. This is perhaps also the appropriate place for observing that the opacity of modern economic life (whose tangle of ramifications makes it difficult for the man in the street to discern its real sense and functions) not only renders true competition more difficult but also probably constitutes one of the chief reasons for today's social malaise. Nothing embitters anyone so much as the feeling of serving as a mere tool in certain inscrutable operations, as a simple-minded person easy to exploit. Hence it is very necessary to provide for maximum publicity in economic life so as to render it transparent and measurable. This is one point in which Europe could learn a great deal from the United States, in particular.

The easiest way to pinpoint the direction which such a comprehensive economic and social policy must take is to regard this policy as one of decentralization in the widest sense of the term. By this, we mean a policy aimed at accomplishing a maximum of diversification and diversion in all fields such as production, housing, administration, distribution of influence, income, property, culture etc. This policy must be implemented in such a way that personal freedom and individual self-determination are not, if possible, impaired by a concentration of power and decision-making. A free market economy forms an important component in such a policy of decentralization because, unlike a centrally planned collective economy, it arranges the regulation of economic life in accordance with spontaneous co-operation between millions of individuals; moreover, it makes people dependent not on the decisions of a handful of individuals but on those of the market with a spontaneous and unconscious interplay between all the numerous individual decisions. However, this decentralization in the regulating of the economic process engendered by a market economy must go hand in hand with decentralization in all other fields if it is to exercise a really effective impact in the political and social fields. Every mammoth enterprise and monopoly, every central association with millions of members, every gigantic city and, even more so, every accumulation of State power in the hands of nationalized enterprise together with bureaucracy, rigid controls and excessive claims on the national income by the State budget are ominous types of concentration, which must be rigorously fought under a policy inspired by market-economy principles. It is interesting to note that a country like Germany, which is able in so many different respects to make a radically new start, provides particularly promising conditions for such a policy because of the necessity of rebuilding cities and resettling millions of people, thereby creating an opportunity for completely new forms of settlement and production.

The Non-Market-Economy Sectors

The dispute about the predominant economic principle is slightly confused in Germany by the erroneous assumption that the market-economy provides a skeleton key capable of opening every door. If such a claim is advanced, then it can hardly prove difficult for critics to show how unjustifiable such a supposition must be. This misunderstanding must be ruled out by clearly distinguishing between the various problems in the field of economic and

social policy and by pinpointing the ambit of those issues to which a free market economy is expected to provide an answer. Essentially, this involves four groups of questions:

- a) Those pertaining to the overall economic order;
- b) Social questions concerning a corrective adjustment to the distribution of income, security, and protection of the weak;
- c) Political questions concerning the distribution of power within the State; and
- d) Socio-anthropological questions concerning deproletarianization, decentralization and the protection of individuality.

It must be emphasized that a market economy only undertakes to supply an answer to the first of these questions. It may well remain an open matter as to how the other issues are best resolved – although always on condition that this does not disrupt or paralyze the workability of the market economy within its narrowly assigned sector of the productive process. Thus, it is perfectly compatible with the principle of the market economy to enlist the help of the Government's financial policy and to draw compulsorily on funds from all incomes formed on the market in order to resolve all those issues which the market economy is either unable to resolve at all or else only unsatisfactorily and inadequately. Furthermore, the prevailing of market-economy principles by no means rules out the possibility of adjusting the pattern of incomes under the market economy with the help of the Government's financial policies i. e. by a certain arrangement of the fiscal system and of expenditure distribution. In other words, it is taken for granted that the market economy will be supplemented by public-finance provisions, which today will be much more wide-ranging than in the past – especially in Germany where such a large segment of the State's expenditure has assumed a compulsory character because of the substantial social-welfare requirements.

On the other hand, a warning should be voiced about the view that this modern extension of the public finance sector might, at best, be nothing else but a necessary evil. It is a collectivist view and inconsistent with the concept of a free market economy to accept the desirability of extending the public-finance sector as much as possible, thus withdrawing an ever larger part of national income from the disposition of the individual citizen and transferring it to the State Leviathan («fiscal socialism»). However, any excessive expansion of the financial sector represents a contradiction of the market economy not only for social but also for purely economic reasons. One cannot force the ratio of the State's utilization of the social product beyond a certain percentage without impairing the expansive and regulative aspects of a free market economy to an increasing degree. In this field, as well, there is a critical point beyond which symptoms of overstrain make themselves felt (a blunting of the impulse to produce, to save and to invest; misinvestment by the State; a growing lack of profitability in the taxation system; a trend towards an inflationary coverage of the State's financial requirements; and the constriction of that part of the productive sector regulated by the market etc). There is virtually no questioning the fact that this critical point has long since been reached and surpassed in the public finance sector in West Germany, too. This in turn imposes the need for a considerable cut in the overall total of public disbursements. The principal starting points for this are probably subsidies, occupation costs and the cost of the administrative machinery, which has been so inflated – especially in the Länder.

Even the reference to public finance in itself as well as the reference to the other unresolved tasks make it clear that we can only speak of a non-collectivist economy in the sense that a free market economy is not the sole principle, but merely the predominating principle. It is a matter for the economic judgment of a government to stipulate the maximum number of permissible non-market-economy sectors and official measures and to ensure homogeneity in economic policy. As today there is in any case a very strong trend towards exceeding this maximum and impairing the homogeneity of economic policy by displacing the market economy, our economic policy-makers would be well-advised to show, from the beginning, distrust and resistance against all these tendencies, and, whenever official action is being

envisaged, to demand clear proof that an impairment of our free market economy is indicated.

In this defensive battle, the adherents of the free-market system can justifiably point to the knots into which their opponents tie themselves. Whilst these critics of the market economy regularly put forward demands which are certain to result in an expansion of the power enjoyed by the public administrative bodies, they are nevertheless unable to sidestep the widespread disapproval of modern bureaucracy. It is illogical on the one hand to call for a reduction in bureaucracy and, on the other hand, to demand an increase in government functions, since these can only be discharged by means of a larger civil service and greater administrative powers. Those who call for a retrenchment of officialdom should bear in mind that they should also logically be calling for an extension of market economy. Perhaps this is the right time and the right place to remind people in Germany of this fact.

The Second Phase of the Social Market Economy: An Additional Concept of a Humane Economy

Alfred Müller-Armack

1960

The Basic Situation

Every economic policy programme needs to be reviewed after a trial phase in terms of its achievements and future objectives. Economic policy programmes cannot be detached from the existing situation. They are best able to fulfil their functions if they provide a cogent answer to a current problem. The social market-economy programme was developed in the period between the Second World War and the German Currency Reform. Since then, German economic policy has been oriented to this model. It represents an attempt to reconcile personal freedom and social security on the basis of free competition. The situation in 1948 was marked by economic paralysis, the result of the destruction wrought by the War and the damaging effects of repressed inflation. Elementary problems of production and distribution, the restoration of the markets for domestic goods and capital, the need to foster fresh confidence in the currency and the reintegration of West Germany into a world economy recovering from the ravages of war were the most tangible problems which had to be solved in order to overcome the existing shortages and the general misery.

Today, even the opponents of the social market economy no longer deny that it proved possible to a surprising degree to create a new basis for the material existence of our nation. In certain phases, there was a tendency to doubt whether it would be possible to achieve social progress in line with the development of private enterprise. But looking back over the 12-year trial period, the social market economy can be said to have proved its ability to have at least resolved the problems of supply confronting an industrial State working within narrow geographical limits. The increase in savings activity in recent years, together with the efforts to place property-ownership on a broader basis, also helps to illustrate that the problems of income and property can in principle be resolved under a social market

economy. Anyone who believes that stricter criteria should be applied may find the progress made so far inadequate. Nevertheless, the present trend of economic expansion ought to demonstrate convincingly that the targets we have failed to achieve so far will come within our reach in the next few years as incomes increase. We can look forward to a situation in which the productive efficiency of our economic system will become increasingly apparent and in which there no longer need to be any feeling of doubt that technological and economic progress will actually benefit the broadest sections of the population.

This trend is particularly clear in our country, but it is also spreading in the other industrial countries of the Free World who are thus following in the steps of prior developments in the United States, albeit at some distance. This success is the result of a tendency throughout the Free World to rely on free market methods, in some countries more strongly than in others. Progress has been speeded up through the use of modern technology and the development of new raw materials and sources of energy, which bring a decisive influence to bear on our present situation. Whereas scientists in the Twenties thought that technical development was reaching its culminating point, the latest technology has long since left that phase and rushed on ahead. We now find ourselves in a period in which automation, better processing methods and better policy-making have created the means for solving the problems of shortage. There can be no doubt that the range of technical opportunities not yet exploited is such that there seems no visible limit to continued economic expansion. An economic programme of the free-market variety cannot stop at the present stage of development. It calls for conscientious observation of the opportunities in question and the goals not yet realized. In the present situation, it calls perhaps even more insistently for the clarification of future problems if we are seriously to regard the social market economy as our model for the future and as an answer to the questions facing us both now and in the years ahead.

The concept of a social economic order based on competition has not only been borne out in practice, it has also come to be accepted as a fully fledged economic system. On the international scene, this is apparent in the growing confidence at least of the leading industrial countries, who have come to the conclusion that free world trade is the best way for them to promote their national economic policy. By contrast, the advocates of national protectionism are unmistakably on the defensive. But this idea has also come to be accepted in the domestic confrontation over West Germany's economic system. The SPD's new programme reveals a much closer identity with the principles of a market economy.

However substantial some of the reservations may be and no matter how much some aspects can only be determined in accordance with party tactics, there is still no mistaking the fact that the market economy principle has won a clear victory over the remnants of Marxist control. The resultant greater degree of harmony in matters of economic policy is definitely a positive trend. It can only serve to benefit our domestic and foreign policy if the basis of common convictions, perhaps hesitantly but nevertheless clearly, becomes broader. One must, however, ask whether this measure of agreement on what constitutes a market economy is sufficient to serve as our model for the future.

On this point, I have my doubts. We must not be content with our domestic successes and the progress we have made in our external relations. The historical change that is taking place so quickly at the present time requires us to reconsider the situation and to redefine the objectives of a social market economy to suit the developments we are moving towards.

Socio-political problems

It has doubtless always been the case in the history of mankind that no sooner has one task been accomplished than new, hitherto unforeseen, problems begin to appear. This is most apparent where the results achieved have been particularly good. It has been possible to cope with the major problem of providing sufficient food and other goods for the community at

large. Yet even the successful efforts to safeguard jobs by achieving full employment and the continuing growth of production have not brought the expected level of social contentment but tended to engender further unrest and dissatisfaction. No reference to the number of achievements to date has succeeded in mitigating this. The mobilization of unrest in our democratic society remains an alarming phenomenon. It was hardly noticeable so long as we stood in the most critical phase of recovery. Now it is coming to the surface everywhere, revealing a weakness in free society which is ubiquitous and hardly responsive to treatment. Even slight price fluctuations meet with a hasty reaction. The claims of firmly organized groups and the views of employers and unions have clashed in an atmosphere of tension, and our economic system lacks the proper remedy for dealing with the situation.

It is only natural in the face of many immoderate demands and the irresponsibility of some of the reactions to them that one should think it necessary to remind both sides of what has been accomplished and to address a moral appeal to them to show moderation and to appreciate that there are limits to progress. Such an appeal is certainly justified, but the limits of its effectiveness are only too obvious. We must ask ourselves whether this restlessness and the excitability of public opinion do not have deeper roots in our conscience and whether they are in fact an indication of those problems in a free society which have simply eluded a solution so far.

I do not believe that people deliberately disregard the progress hitherto made. Most of us are no doubt realistic enough to appreciate it. If the price of a few articles goes up and this causes general disquiet, it stems not so much from the actual extra burden on our incomes because of the higher prices as from the fear that we may again get caught up in a mechanism of inflation. That is a development which could have unforeseeable disadvantages. Those who condemn this attitude as materialistic do not appreciate the position of the individual in society as a whole. Admittedly, problems have been solved. There have been unprecedented improvements in the supply of goods, and indeed a large number of people have even been able to build their own homes and save money. Despite this, the range of tasks which has to be accomplished for the individual in a free society is incomparably broader and certainly goes beyond what has been achieved so far. It is no coincidence, then, just as we have reached the first climax in our efforts to meet society's material needs that the fragmentary character of the work done so far becomes apparent and expresses itself in what seems to be an almost irrational reaction.

If we go deeper into the matter, we see that a democratic society which has been activated by unprecedented industrial expansion and also shaken up in the process needs to make particularly great efforts in the social field in order to recreate in a manner commensurate with modern requirements the quality of life which has been lost as a result of industrialization, the growth of transport and the dismantling of traditional links with the local neighbourhood or the accustomed independent trades and occupations. Ours has been called a classless society. This description can be taken as a sign not only that the workers have emerged from the proletariat stage but also that the distribution of property-ownership and the patterns of working life are now in a state of flux. As regards modern consumer goods including the motor car, television sets and other electrical appliances, there has been a wider spread of consumption. These things are no longer the privilege of one particular class.

In this classless society, it is no longer the classes who are the problem but the individual. It is he who feels inferior to society as a whole and uncertain of himself. He has a greater awareness of the problem as to how and where he is to find his position in that society than was the case under the more rigid system of the past. Vis-à-vis society as a whole, the individual is bound to feel that his entry into certain occupations, his advancement and his integration into a particular environment are fraught with uncertainties which he cannot gauge properly. Economic cycles, market fluctuations and readjustments of production operations harness him to mechanisms which appear anonymous and which he finds hard to understand. It is small wonder that he is gripped by hesitation and an indefinable fear of what

await him in his environment, both now and in the future, and that he therefore joins various groups and organizations which pass on his inner restlessness to the public at large in amplified form.

This is the situation we have to start from when defining the goals of the second phase which the social market economy is now entering. The progress achieved so far with regard to the development of production, income structures and the spread of wealth among the broadest strata of the population will of course have to be continued. To that extent, the continuity must be maintained as the social market economy grows. But we shall not attain our goals unless we complement the social market economy with a crucially important social programme.

The architects of the social market economy have always seen it as a unit, as a compact economic policy embedded in a more comprehensive concept of a humane society. But we must do a great deal more to give concrete expression to that wholeness. By no means should we seek to evade the issue by adopting a moral posture. There is, of course, no reason at all why we should underrate the dignity and value of a stronger ethical basis in trade and commerce. Yet to be content with that would be expecting too much of an appeal to the nation's moral fibre. We might then fail to appreciate that the moral task of shaping our society would come to nothing if we did not show very specific ways and methods of conducting such a policy in a free society. The main reason for the success of our social market economy so far is the fact that this concept resulted in an very detailed programme which set out the practical methods of achieving the idealistic aim of harmonizing social security and economic liberty. Similarly, the primary task today is to translate into practice an altruistic aim on which there can now hardly be any difference of opinion.

In the currently unstable situation of a classless society, there is a need for built-in social stabilizers, i. e. institutions which will make individuals who find themselves forced into isolation aware of the totality of this social concept and the actual security to be found within it. A free society is less transparent to the individual than a system of controls. As Miksch quite rightly said, this is simple in theory but complicated in practice. Obviously, a system which functions well and stands beyond doubt is not in itself enough to remove the suspicious attitude towards a free market economy. This kind of attitude flows not only from an inability to grasp the meaning of a system based on competition but from the uncertainty inherent in the prevailing atmosphere and expressing itself in the erosion of traditional ties. A purely educational therapy will not be enough to cope with this situation. What we need is the deliberate creation of a new stability from the fundamental situation of today's society. The flow of its economic expansion, its techniques and its sociological restructuration have such force and carry us forward so quickly that the vanishing outline of the old banks of the river will help us but little in our navigation if we do not adapt ourselves to the speed of the current.

The Principle of a New Strategy for a Humane Society

If we asked ourselves what a policy for a humane society under a free system should be like, there would hardly arise any dispute that problems of restructuring society will have priority over economic problems during the next phase of our social market economy. For a number of years now, those concerned with this matter have come to appreciate the need for a development in this direction. But to my mind this problem has not been tackled in its entirety. The efforts to create new forms of ownership among broad sections of the population, ranging from savings bonuses via house ownership to people's shares, clearly deserve the most careful support. But their scope is limited inasmuch as the task of finding a satisfactory solution to the question of income as well as property-ownership is only one aspect of the fundamental problem, i. e. that of meeting people's material needs. It does not

resolve the problem as a whole. And the attempt to create a solid stratum of small and medium-sized firms points in the same direction. It is indeed extremely important to maintain a balance between the different types of establishments. However, a more general social policy must not merely safeguard the present independent firms; it must also make it possible for others to become self-employed if it is not to become tangled in a retrogressive ideology. In terms of general social policy, those seeking to become self-employed, in whatever form, deserve to have priority. Industrial decentralization can also help this process, as can the transfer of genuine responsibility to individual sectors. Naturally, ownership may also create such independent sectors in that it arouses – both in a material and a purely psychological sense – an interest in, and a desire for independence.

A general social policy genuinely based on the existing situation must start from reality in order to embrace the economy as a whole. In other words, it must develop objectives which perceive the economy as a mass organization if it is not to deteriorate into an ideology which corresponds to no more than a previous social situation. Thus, governmental measures to remove the so-called concentration of power in industry, the indisputable achievements of which have largely been responsible for the nation's higher standard of living, would have little prospect of success. The Government should therefore confine its efforts to containing restrictive market monopolization by means of tax policy and appropriate legislation in order to safeguard competition, and wherever market influence goes hand in hand with reduced prices and an above-average rate of expansion, we must recognize that it is indispensable. The problems to be tackled in the Common Market will in any case require larger enterprises.

In this past year in particular, frequent attempts have been made by means of partial adjustments of tax regulations to help certain categories of retail firms, service trades, small and medium-sized industries and agricultural holdings. But a social policy of this kind, which goes no further than technical alternations, will not meet the psychological requirements. We need to develop a «general social policy image» which, apart from being the starting point for practical measures, must also enable us to open up a whole spectrum of objectives in the social sphere which the individual in the mass society of today can perceive as a whole and identify with as such. Certainly, the social market economy provided an integrating image of this kind in its initial phase. But now we are faced with the new task of drafting a general social policy, which will be able to assume similar functions in the future.

One of the reasons why socialist and communist propaganda has been so easily remembered is undoubtedly the fact that it was able to offer something complete which even the least intelligent could understand. Obviously, a free society cannot simply proceed along the same lines. Nevertheless, similar to the way in which the social market economy proved that easily understandable aims need not be alien to a liberal system, we should explore the possibilities afforded by a liberal policy for a free society as to whether it offers something of a similar nature. It has been said time and time again that the individual should be the focal point of economic activity. This is certainly true, but the important thing now consists in expressing this general maxim in concrete terms. In doing so, we are effecting a change of course, as it were, in our interpretation of the social market economy. Whereas its substance has hitherto largely been determined by the economic policy to be pursued within its framework, it is now a matter of making the economic basis created by that economic policy the foundation for further social development.

The Objectives of a Humane Social Policy

A humane social policy involves more than an economic policy. The various elements which it has so far been possible to group together within the sphere of responsibility of a few government departments must be pursued as an overall social policy at another level. Not

only the Federal Government, the Länder and local authorities but also public and private groups, organized groups and individual enterprises must now work to achieve the same aims.

1. The present-day trend in industry is towards skilled labour. The demand for highly skilled labour of all categories (whether technicians, administrative personnel, teachers, doctors and members of other free professions) is growing to such an extent as to be an encouragement to invest in skilled manpower on a far greater scale than hitherto. When discussing the huge numbers seeking admission to the universities, the fact is all too often overlooked that the real problem consists not in the actual numbers of applicants but in the lack of capacity of the existing institutions. Whereas in past decades, the absorptive capacity of the various careers was very limited and therefore had to be constantly taken into account, the demand for ever better qualified manpower has considerably eased the task of helping young people trying to find their place in this society, to enter professional life and seek advancement in their chosen careers. It appears that the time has come to pursue this aim with all the available means and, moreover, to make this system so evident that the individual will from the very outset have no fear of being unable to find his way in a mass society. Apart from enlarging the universities, it will also be necessary to provide more intermediate schools affording a general education and also professional specialization in order to meet the demand for middle-level skilled labour (prolonged time of school education). The efforts being made in the leading countries of the East and West indicate that we are not doing enough in this respect. Nor is it enough to invest heavily in science, research and education – which no doubt is being done – unless this has been integrated into a general social programme as the foremost task. There is no need to go into the details of this increase in the quality of labour. They are reflected in the traditional careers taken up after the existing courses of education and training have been completed. Let it suffice to say that planning of the nation's skilled manpower should be more purposefully adapted to the structure of industry in the next few decades on the basis of an individual's freedom of choice.

2. The second task I wish to mention is the creation of more self-employment. It is not enough to think primarily in terms of small and medium-sized businesses, though by that I am not questioning their importance. Self-employment in the broadest sense cannot, in a free society, be restricted to individual groups keen to safeguard their positions even to the extent of accepting intervention which militates against the principle of competition. What we need is a realistic programme to create more opportunities to become self-employed in the various occupations ranging from farmer to craftsman, from tradesman to industrialist and members of the free professions. The process by which people become independent is certainly difficult to institutionalize, and I am by no means suggesting that an attempt should be made to create absolute equality of opportunity. But considering the many sources of assistance which existing professions enjoy – in some cases involving restraints on competition – and considering the many legal impediments to access in the form of examinations etc., an effort should be made to give those wishing to become self-employed the advantages that will encourage them to take this step i. e. by means of direct or indirect tax concessions. Such a policy would at the same time increase competition and not contravene basic market principles.

Self-employment in this sense is of course always restricted to a small category of small and medium-sized firms and free professions. But it is of no less urgency to give the non-self-employed person in a free society the opportunities which will enable him to play a real part. This is no doubt already largely the case as regards the many employees and managers in our large industrial companies, but the possibilities in the firms themselves have not been exhausted for establishing social groups of both white collar and blue collar workers by a well-devised division of labour and for transferring to them responsibilities which will give the individual a natural degree of independence within the enterprise as a whole. Making long-serving workers salaried employees, for instance, could create opportunities for

advancement among broad sections of the community. In this connection, we can proceed on the basis of the work of various study groups who, over the past ten years, have been trying to improve the structure of the workforce. So far this has mainly been a private initiative, but now, after a trial period, it should be incorporated within our social policy concept. All this would have to be brought to the attention of the community by means of a systematic publicity campaign.

3. It will be necessary to establish what the individual – who feels himself to be playing an anonymous and helpless role in a classless society – really expects, either unconsciously or explicitly, from that society. He must not only be given the opportunity to find his place in society, and to receive the necessary training and employment. It is equally important to allay his fear, whether justified or not, of the mechanisms of a free economy to which he feels exposed.

I would mention first and foremost the problem of monetary stability, which has considerable social implications. Even those who have earned well and acquired assets are afraid of the effects of creeping, or worse still, open inflation. Since the transition to convertibility (and in West Germany since the Currency Reform), a policy of financial stability has been the declared aim. Yet, it is equally clear that even countries with hard currencies have not been fully able to counter the trend towards a slight but nevertheless perceptible devaluation. In future, the Government will have to be more resolute in halting this process at source. Verbal promises will not be sufficient; there will have to be a specific commitment to do so. The possibilities for offsetting unavoidable price increases in sectors of low productivity growth by reducing prices in branches of industry with a high rate of productivity have not been fully exhausted. Here and in other countries, it has been said that we must expect about 20 per cent inflation every decade. We seem to have become resigned to this far too soon. If it proves impossible to influence this trend by means of economic policies, we should consider other ways of providing savers and earners of income with constitutional safeguards against inflation beyond a certain level.

The worst kind of uncertainty that can effect the individual has long been the danger ensuing from business cycles. Since the Thirties, instruments have been developed to make this danger controllable. Little can be done about recessive tendencies in individual sectors of the economy. They will have to be put up with as long as it is possible to maintain steady expansion of the economy as a whole. But the mere availability of anticyclical instruments is not sufficient to give the individual an adequate feeling of security. What we need in fact is an institutionalization of such instruments. So far, tentative steps in this direction have only been taken by a few countries. Just as we have made the rules of competition as described by *Franz Böhm* a public responsibility, so trade cycle policy should also become a legitimate link in our social policy chain. This calls for the creation of efficient national authorities and to no less a degree of international co-operation as launched on the basis of the OEEC and, more recently, the EEC. This process should not remain locked away in the minds of a few experts. Apart from the practical implementation of measures to combat crises and cycles on a transatlantic basis embracing the United States and Canada, there should also be a general publicity campaign in order to make it clear to every individual that our free Western society has found the means with which to prevent any repetition of those economic crises which all communists since Lenin have hoped will undermine democratic nations.

4. The object of all these endeavours is a social policy representing an attempt not only to resolve production problems, but also to apply measures relating to the totality of the environment in which each individual member of our industrial society lives. Apart from opportunities for advancement, training, currency stability and the economic stability in general, it is the firm which constitutes the most important element in each employee's environment. We have already touched upon the possibility of independent work within the firm. It is no less urgent to make an additional effort in West Germany to draw level with countries like the United States and Britain – indeed, as some thoughtful observers have

remarked, even with Russia – in an intensive effort to re-organize the specific environment of the firm. We in West Germany have given priority to the legal aspects of the Labour/Management Relations Act. Much more still needs to be done about accident prevention and health care at work. The United States have a much better record as regards the number of industrial accidents and that country has also shown that it will hardly be possible to boost production without the introduction, for instance, of better methods of ventilation and dust-removal in industrial establishments, providing better health services, etc. It would certainly be a short-sighted approach merely to think of the extra financial burden and to overlook the fact that substantial progress is necessary in this direction in order to make the individual the focal point of industrial activity as this becomes increasingly intensive and places a greater strain on employees. Such progress is also essential. However, in order to improve the atmosphere at work as well as to maintain the upward trend in production.

This is more or less in line with *Alexander Rüstow's* «Vitalpolitik», which goes beyond economic issues and concerns itself with the «vital unity» of man. We cannot establish such unity of the human environment solely in the family, in the home and in the garden. Whether he likes it or not, man exists today within a much wider environment and it is an environment which would be inconceivable without his life in the firm. Future law-makers will have no option but to introduce stricter rules than those established in an age when the factory was seen above all as a place of mechanical production. We can consider it a happy coincidence that – as with so many elements of the market economy – the aim of increased productivity and that of providing better social conditions are also in harmony as regards industrial reform.

5. This shaping of our environment must become one of the general tasks in public life. This includes the goal of keeping our air and water clean, a task which has already been set in train but will certainly have to be pursued with greater energy. But in this regard we are still too much in a technical area in which, even though the individual may be adversely affected, it will be difficult to approach him directly.

But the problem of the social environment must be approached on a much broader and a much more concrete basis and related to the individual. In recent decades, the rapid development of industry and transport has considerably impaired the natural environment. But in spite of extensive scientific research and practical efforts, our regional and town planners – apart from the felicitous examples of the Ruhr settlement association and a few urban development projects – have failed to provide even the outline of a meaningful solution. Idealistic concepts such as proposals for de-congesting industrial areas have helped to discredit regional planning activities even where the aims were plausible. The years of recovery were excessively influenced by the aim of reconstructing our factories and building modern road networks, and little thought was given to the consequences of the resultant chaotic structure of the environment.

All this was compounded by the idea that a market economy system should be based on a minimum of governmental activity. That is true to the extent that state management in industry or nationalization in a country which has sufficient private enterprise available can be deemed superfluous and would be unlikely to improve the standard of living of the population. But just as rules on competition form an indispensable framework in the neo-liberal view, too, the State – the more it seems to become dispensable for actual economic activity – should turn its attention to its responsibilities with regard to the establishment of an environmental code. This is necessary in order to incorporate the dynamic forces of industry and transport into a meaningful pattern of society.

Greater efforts will be required to improve the planning of our towns, cities and villages. Who will deny that community life has become chaotic owing to the non-delimitation of functional zones and to the sacrifice of unity because of the traffic arteries cutting through them? It has been convincingly explained in a most interesting analysis of the sociology of urbanization that, whilst town-dwellers like the urban way of life, they avoid town centres

because they no longer provide the conditions for a well-ordered communal life. The exodus into the suburbs and countryside is not an expression of censure by nature-lovers but by town-dwellers to whom the town denies the kind of life they want. This gives rise to senseless commuting, which makes people even more restless and causes the tension which contrasts so poignantly with the general increase in prosperity. These problems must not be left to chance. Our cities and landscapes must be planned according to their functions. Decisions on the creation of commercial centres, administrative areas, cultural centres and residential areas cannot be left to local authorities alone. A common effort is required and central government funds must be made available. Business and housing areas should have a common system of access to the tax revenues extending beyond the community's political boundaries. The national parks in the United States should be imitated on a smaller scale in Europe. Growing agricultural production in the EEC will soon lead to surpluses, so that in the next few years some farming land can be put to different uses.

This task should not be seen merely as a restorative regional policy. Important as it is to preserve the historical structure of town centres, we must look well beyond that objective and provide for the growth of our towns in a way which will enable them to become centres of urban life.

I consider it to be important as a means of maintaining a city's balance for such plans to place the natural movement of people in their capacity as pedestrians on a par with traffic. This is what the then Chancellor, *Dr. Adenauer*, had in mind when he called upon Cologne's city fathers to switch the life of the city back to the Rhine for the sake of the people, because the city centre had been practically cut off by an extremely busy road. Of course, all such developments have to be worked out in detail, but the problem as such should be appreciated so that our social structure can be firmly influenced from this angle and furnish a new orientation for the individual.

6. Under this programme for a free society, economic policy will not only have to perform its present function but also to discharge additional tasks. Unless all the signs are deceptive, the dynamism of our country's output expansion will continue to grow and inevitably bring out the disparities between old and new processes. The consequences of automation, the introduction of new materials and the growing competition between old and new sources of energy are already quite distinct.

Let me take energy as an example. If the regulation of this problem were to be left entirely to competition, future economic development would be locked in a permanent crisis – especially as regards coal. This would be just as much a mistake as to attempt to check competition by means of central controls since that would, to all intents and purposes, prevent oil and gas and nuclear energy from raising the standard of living! The Government should try – as indeed it started to do last year in the coal sector but with far too little determination – to stimulate greater mobility among miners, where necessary in terms of the market economy, by giving local authorities grants to finance retraining schemes and by providing loans for new firms so as to ensure a smoother transition to new trades than in the past. In some branches of the economy such as the energy sector, which are characterized by very different degrees of development, a suitable balance must be established between the need for a stable market situation in the traditional sectors and the need for continued rapid expansion in those sectors which use the most modern methods of production. This cannot be achieved either by government controls which hamper the market or by completely free, *laissez-faire* competition. Those branches of the economy which find themselves on the defensive should be helped by increasing their mobility and adaptability or by making it easier for them to meet their fixed costs and hence to adjust proportional costs to the price of competing products.

On the other hand, every effort should be undertaken to ensure in those areas where productivity can be boosted that prices are reduced in good time to enable technical progress to lead as quickly as possible to an increase in the standard of living and a reduction in the

burdens on the working population. In view of the increase in prices automatically resulting from the general pay rises in low productivity sectors and in the services sector, only such a policy can check inflation and maintain the level of purchasing power.

In the field of welfare policy, too, the present work will have to continue but with the possibility of overall adjustments. As economic expansion grows apace, more and more sections of the population will be in a position where they can be expected to do more to help themselves. This aspect should receive more consideration so that assistance can be concentrated on those who really need it. Such a division into basic assistance provided by the State and social security on the one hand and additional security provisions left to the individual's own initiative would be more consistent with the needs of society today than the frequent denunciations, mostly ideologically motivated, of the principle of the «welfare State».

7. The humane social policy pursued in the Free World should not be introverted. The present-day social environment is more international than it has ever been, so that we must see the consequences of our international trade relations increasingly in terms of our domestic structure. Economic expansion as well as economic and social security presuppose a firm integration into the nexus of international relations. Hence, the process of European integration is of special importance for us in strengthening the stability of our economy. We are now aware more than ever that such integration must not infringe the recognized rules of international relations. But we cannot forgo union with those nations of Europe with whom we share a common political destiny.

The problem of trade policy has received undue attention in recent years. During the next few years, an arrangement will have to be agreed upon within the OEEC area, (i. e. in the process of Atlantic co-operation embracing the United States and Canada), and this will provide for non-discriminatory treatment of the Europeans. No less important in my view is a harmonization of anticyclical policies between the members of OEEC and EEC. This will indeed be the essential basis for the economic expansion now taking place throughout Europe to proceed harmoniously and without any setbacks. Only the resolute pursuit of this objective can give the nations of Europe and our own country that secure framework for their economic environment which is necessary in order to allay the permanent fear of possible setbacks. I have attempted to summarize the results of our deliberations within the OEEC and EEC in a «code of rational conduct in an anticyclical policy». Much preparation has already been made in these organizations.

All States have affirmed the significance of this task. Yet beyond the efforts of the experts, the political incentive is lacking to set the process in motion and to propagate it as an integral part of a social objective. And there is the additional goal of helping the developing countries. It is a task to which the Europeans have to address themselves. At the same time, it is a responsibility which affords them opportunities for stabilizing their exports. In essence, it is a socio-political task vis-à-vis the developing countries themselves, who have not yet had a chance to share in the solution of the basic economic problem which the industrial countries have mastered in principle. It is gratifying to note how the world is becoming increasingly aware of the need to help developing countries. This issue should be seen from the standpoint of our domestic social policy. In other words, structures and methods should be developed in order to raise the level of production and purchasing power of developable regions, where possible by increasing the production of goods for their own needs, promoting their industrialization, and at the same time enabling them to achieve the internal equilibrium that will have to stand the strain inherent in new economic structures in the initial phase.

The above socio-political programme could be supplemented in various different ways. My aim was simply to show to what little extent the scope for shaping a social market economy as the life-style of a free society has been exploited. As in the past – when it proved possible to develop a comprehensive economic and social policy in all sectors based on the principle of a free economy – we once more face new and comprehensive tasks. They will no doubt involve expenditure and burdens, but the present level of production and the likely trend of productivity suggest that it will be possible to keep those burdens within limits. This applies all the more so, since the results of such a policy will be partly self-sustaining as the economic process provides more security and stability.

The reorganization of our social environment calls for an adjustment of our economic and financial policy to the same extent as production and investment problems are solved by the free economy itself. This must be accomplished if the State is to be relieved of all those various means of assistance for the private sector which represent such a considerable financial burden at the present time. Parallel to this relief and with appropriate use being made of the funds accruing to the State as a result of economic expansion, the public services should be improved in both quality and quantity and in line with the general concept proposed in this context.

To modern man, a satisfactory reorganization of the environment depends not only on his opportunities for production and consumption, which he himself can influence, but on the public services made available by the State, on schools, health services, roads and housing, on security and general administration, etc. This sector largely determines the shape of the environment in which, beyond our private and working life, we spend our lives. In general, it can be said that public services have not kept abreast of the community's productive performance. We produce property without adequately protecting it against loss of value through monetary and economic decline; we produce cars without building adequate roads for them. In nearly all sectors of public life, services have proved incapable of keeping pace with private sector activity. Compared with large payments for specialized pressure groups, the public funds available for improving the general environment are limited to residual budgetary amounts; they can be defended all the less if they are not supported by massive vested interests.

The present situation makes it imperative to increase the volume of those public funds which are needed to develop the environment we inhabit in a meaningful and harmonious manner. The continuing expansion of the consumer goods sector will soon be of little interest to most people unless it goes hand in hand with more public spending to improve the environment as a whole. Naturally, it is not sufficient merely to increase the funds earmarked for public services. What we need is in fact a qualitative reorientation along the lines mentioned above. Only if we have a leitmotif for the rational design of community life can we determine where the injection of public funds is most urgently needed. This implies a budgeting programme which reviews «political items» of the past and fixes a new order of priorities based on the criteria for a well-balanced social structure.

Protecting our Free Society – the Responsibility of Economic and Social Policy

We must become conscious of the economic possibilities that have accrued and will continue to accrue to us. An economic policy which unthinkingly follows its present course is certain to come to grief as a result of the indifference shown by those it is intended to serve, but for whose situation it shows no appreciation. A free society also needs a lodestar to guide it into the future. It will be up to the political groups in particular to present the goal so clearly to the people that they will accept it as something worth striving for. Only in this way

will it be possible to fill the vacuum in our society that is so obvious. This task can only be accomplished if we start from the basis of our common values and convictions. But what we need in this age is a realistic idealism which has a clear picture of what can be achieved and which unites all sections of society – businessmen, farmers, trade unions, consumers, big and small companies, etc., and including those with political responsibility – all aware of their duty to uphold a meaningful social order.

A free society must see freedom as an entity, one of whose integral parts – apart from political, religious and intellectual freedom – is economic freedom. Up to now, collectivistic ideology has been based on the premise that economic freedom is of less value than the other freedoms, the object being to break the chain constituting a free society at its weakest link. Hence, we can only protect the political and spiritual roots of our free society if we reform its economic and social elements on the broadest possible basis as the manifestation of a specific mental orientation.

Propositions in brief

1. Now that production problems have been resolved through full employment, the main emphasis in our social market economy will shift to other areas. In future, it must be understood as a policy for a free society.

2. The shifts in the pattern of labour, incomes and ownership present a picture of a classless society in which the individual may no longer be seen primarily as a member of a particular group. It is now important to reconsider the political needs of a society which has undergone this equalization process.

3. Although it is necessary to continue the assistance for specific social and economic groups, it will be essential to pursue a complementary and humane social policy which will meet the community's requirements in the coming decades.

4. Inasmuch it is produced by concrete facts, the vacuum causing the unrest in our society clearly stems from the flaws in our environmental structure. In shaping that environment, we have been unable to keep up with the advance of production technology.

5. Owing to the growing demand for skilled labour, more training and study facilities will have to be provided. The promotion of science and research should be seen not only in terms of cultural policy but within the wider scope of economic and social policy.

6. Not only the developing countries need to invest in «brain power». The industrial countries themselves have by no means reached the optimum in this respect.

7. The people who have become uncertain of their place in society must be provided with institutional safeguards, especially as regards the conditions which they cannot influence themselves on their own responsibility.

8. An institutionalized national and international economic policy will ensure full employment and steady expansion, thus establishing an important stabilizing factor.

9. Monetary stability is one of the essential elements in a free society. Further safeguards are necessary to maintain that stability.

10. A free society must encourage self-employment in all its forms. Apart from preserving existing businesses, it is extremely important to create further opportunities for self-employment.

11. The promotion of self-employment and independence must also embrace the growing numbers of those who, in formal terms, are engaged in non-independent activities. The experience gained from the changing pattern of labour/management relations should be used on a more widespread basis.

12. Nor has optimum progress been achieved in West Germany in regard to the modernization of medical facilities and accident-prevention procedures, etc. Progress in this field would also help increase productivity.

13. Regional planning has for the most part been seen in terms of industrial distribution. This should be reoriented towards the shaping of the social environment. That includes, in particular, the meaningful integration of industries, transport services, residential and recreational areas, etc.

14. Road-building plans must be consistent with an overall scheme for the environment.

15. Economic expansion makes it possible to concentrate social security measures on certain areas of priority in order to create a better balance between individual responsibility and more effective aid.

16. In the light of technical progress, everything should be done to achieve the earliest possible impact of newly developed products. If it proves necessary to protect traditional industries, the assistance given to enable them to adapt to modern requirements should enjoy priority over government safeguards.

17. The development and restructuring of society presupposes the readjustment of budgetary policy. Corresponding to the rate of expansion, more funds on a more selective basis – with the discontinuation of all dispensable subsidies to the private sector – should be provided on the scale necessary for the type of environment that will be conducive to such expansion. The strengthening of the public sector in the sense of creating such an environmental framework must rest on a specific concept for our society.

Our Social Model: an Integrated Society

Ludwig Erhard

1965

In political terms, German society is no longer a class society. The awareness of mutual dependence and the appreciation of the need to make progress has strengthened the wish of all social groups for reciprocal understanding to an extent unthinkable during the Weimar Republic era, for example.

Despite that, I would not characterize the current state of society as satisfactory. An unproductive restlessness on the one hand is matched by a sterile opportunism on the other. Both manifestations stem from the same source: a single-minded quest for material prosperity. This involves the danger that the State and society will content themselves with satisfying solely the superficial material interests of the various groups and interests. But it is precisely because the German nation has overcome an epoch of social conflicts and radical movements, civil war and dictatorship that it now feels a deep-seated need for clarity and certainty about what direction our society should take and what aims it ought to be pursuing. Moreover, these aims must not be exclusively material in nature but also spiritual. It is becoming more and more manifest in our country that such a society cannot exist solely in order to satisfy sectional self-interests. On the contrary, it must be inspired by a sensitive awareness of its integrality and by its will to succeed. In other words, a democratic society must develop from within itself. The society to which we aspire can best be described as an «integrated society».

I recently heard the view expressed that this concept of an integrated society was «merely» philosophical. My rejoinder to that is: «what would become of us if we were no longer capable of philosophizing about our society i. e. thinking about our very existence?» The social market economy also rests on a philosophy of modern society. Without it, we would certainly not have proved capable of achieving such great material successes. The belief that politics only result from day-to-day exigencies is a widespread fallacy. In point of fact, they require continuous mental re-assessment and presuppose the boldness of free thought.

The special features of Germany's history and the experience gathered by the German

people, together with what the English historian *Toynbee* called the challenge of history, have advanced the process of social formation in Germany much farther than in other Western industrial states.

The various groups of society no longer have the character of «movements» (e. g. the workers' movement, the women's movement). Instead, they have become firm institutions. Now that they have reached the limits of their organizational expansion, they tend to discharge their specific functions more and more within the overall social framework. They are becoming more of a firm component in modern democracy and safeguarding it against excessive pluralism.

A purposive social policy will, for example, have to direct its attention in future more to the overall needs of society and less to those of individuals. Needless to say, this will call for great material resources.

The solidarity evinced by an integrated society will result in the community assuming a social guarantee for the individual. But it is the individual who must be free-minded enough to find the necessary courage and will-power. An integrated society cannot be dictated to by the State: the Government and Parliament alike can only appeal to people's common sense in asserting their authority and in applying modern political techniques (opinion polls, sophisticated communications and comprehensive information media).

Those who go through life with open eyes and ears will soon observe that we have already started to set up our «integrated society» and to perfect it more and more. Today, our task is to acquire greater personal awareness of this process. The rational clarity, the prudence and the intelligibility peculiar to an integrated society enable the individual to fit into the world around him without the tension of intellectual maladjustment. Such a society is in every respect well protected against crises.

If this step forward is successful, then the magnetism of the integrated society will prove superior to that of all other social patterns. Both ideologically and politically, it will erode socialism – a process which has already begun. Part of this process will consist in the further development of our relations with the countries of Asia, Africa and Latin America. All these States are in search of a model which will permit them to devise a synthesis of freedom and order, a modern technological economy and the preservation of old cultural values.

Our society can be described as «integrated» if it is simultaneously capable of sustained efforts to work and produce and if its objectives and endeavours go beyond the safeguarding of individual existence. Unlike primitive or totalitarian societies, it has no need of an external enemy. But it does need the intellectual energy which derives from a knowledge of great historic missions and the will to gain human freedom for a new epoch in history.

Social Market Economy and Demand Management: Two Experiments in Economic Policy

Egon Tüchtfeldt

1973

I. On the Development of the Social Market Economy

1. Conceptual Elements of the Social Market Economy

The fundamental idea behind the «Soziale Marktwirtschaft» (Social Market Economy) consists, to use *Alfred Müller-Armack's* succinct and precise phrase, in «combining the principle of the freedom of the market with that of social security». This concept can be characterized in a greatly simplified form by six conceptual elements as follows:

1. The basic regulative principle is the freedom of the individual, which is manifested in competition. In other words, the market processes should, as far as possible, take place in the form of competition processes.

2. Social tensions and problems which cannot be mastered through the market should be solved by an appropriate social security policy.

3. The fluctuations in economic activity inherent in every industrial society should be diminished by business-cycle policy, which offsets disequilibria (compensatory policy).

4. The important consideration in growth policy is to create the legal and infrastructural conditions for as smooth an economic development as possible. On the other hand, governmental planning of the growth process violates free market principles because it constitutes a presumption of knowledge (*F. A. von Hayek*). Hence, any kind of official direction of investment debases the market economy.

5. Within the ambit of economic structure, there are a number of markets in which the market-place fails to function correctly for various understandable technical or other practical reasons. Where long-term difficulties in structural adaptation arise and branches of industry or certain regions of the country get into difficulties, then a sound structural policy may well be the source of grants to assist adjustment. Wherever the results of the market are

not desirable for regulatory, political or military reasons (e. g. due to the need for safe supplies in times of crisis and war), the measures adopted for maintaining the structure of the economy ought to be kept as transparent and efficient as possible.

6. The intervention criterion for all measures serving to complement and correct market processes is conformity to market principles: i. e. economic policy measures should distort or disturb market processes as little as possible.

These six elements together make up a conceptual unit. It represents – especially in comparison with former ad hoc state interventionism, which often does not conform to market principles – «economic policy in one piece».

2. Historical Prerequisites for the Success of the Social Market Economy

In the first decade following the Currency Reform in 1948, the unprecedented successes were all attributed to the Social Market Economy. In this context, however, one should not forget that the vigorous reconstruction phase following the Currency Reform was not solely a result of the Social Market Economy concept, but was also caused by the historically unprecedented coincidence of a series of different factors. In this respect, the concept of the Social Market Economy was a necessary, but not sufficient precondition for the «economic miracle». We know both from economic history and from the experience of today's developing countries that it is by no means enough to set free individual forces. Further conditions must be present. In the case of the Federal Republic of Germany, the following seven factors constituted these conditions:

1. Thanks to his optimism and his unshakable conviction of the correctness of the course taken, *Ludwig Erhard* succeeded, despite initial difficulties, in convincing most of those who were sceptical of the new experiment.

2. The need to reconstruct the production plants, which were largely destroyed, made a fundamental technological modernization possible. After the Social Market Economy had been in force for a decade, the Federal Republic had more modern production plants at its disposal than those industrial countries which had not suffered any appreciable war damage. An important part in this was played by the generous fiscal concessions made to self-financing, without which it would not have been possible to overcome the enormous shortage of capital so quickly.

3. In the first decade of the Social Market Economy, there was virtually an unlimited supply of labour. The most important factor here is that, from 1944, over ten million refugees and expelled persons flocked into the territory that later became the Federal Republic. Hence, the expansion of the production plants was in no way limited by the labour market. The unemployment rate, which had stood at approximately 15% as late as February 1950, fell to below 1% in 1960.

4. The initial difficulties in the foreign exchange sector were likewise circumvented by generous American aid (Marshall Plan). The Federal Republic was therefore in a position to import foodstuffs and raw materials in amounts that made unrestrained development possible.

5. The business-cycle movements were – with the exception of the exogenously induced Korean boom – relatively small.

6. Business-cycle policy was based essentially on traditional monetary policy, which, because there was still a lack of convertibility at that time, could not be influenced from abroad.

7. Internal developments showed an unusual degree of stability. *Adenauer* was Federal Chancellor and *Erhard* Minister for Economic Affairs for three and a half legislative periods, from 1949–1963. The safeguarding of the Social Market Economy through this internal stability was beneficial to the investment climate to an extent that can best be measured by a

comparison with other industrial countries that were shaken by too much unrest in domestic policy.

These seven factors, which made the essential contribution to the speedy reconstruction, provided unusually favourable starting conditions for the Social Market Economy experiment. The partial disappearance of these conditions led to a «deterioration in the economic climate», which, since it was inadequately mastered politically, initially caused a decay in the concept of the Social Market Economy and finally its replacement by the new experiment of Demand Management.

3. Deterioration in the Economic Climate after the End of the Fifties

The first decade was in many respects the «golden age» of the Social Market Economy. It was possible to extend this concept step by step to more and more sectors of the economy. However, there then followed another coincidence of historically unprecedented influences which, on this occasion, had an unfavourable effect. There are in particular five factors that should be mentioned here:

1. At the end of 1958, most European industrial countries returned to convertibility. As such, this was a very significant step forward. But at the same time it led to the so-called «hole at the border» that was so fatal for internal stability policy. As the problems of safeguarding the economy against external influences had remained unknown since the World Economic Crisis, the economy was not sufficiently prepared for it. Traditional monetary policy did not operate any more. The instruments available at that time were not effective enough to allow the combined use of monetary, financial and foreign trade policy. The EEC, founded in 1958, further narrowed the scope for manoeuvre in business-cycle policy. The first revaluation of the D-Mark in 1961 was one of the consequences of this.

2. After the end of the reconstruction phase, the rapid growth of productive capacity slowed down. The elasticity of production fell accordingly.

3. Labour also became short, since the size of the domestic working population began to contract and the inflow of refugees was cut by the building of the Berlin Wall. In order to feed the needs of expansion, the economy had to rely on foreign labour, and this caused a qualitative deterioration.

4. After achieving full employment in 1959, when, for the first time, the number of unemployed and the number of job vacancies were equal, the fight over the distribution began, and with it the well-known conflict between the aims of full employment and price stability. An increasing hardening of positions in labour relations became noticeable.

5. The consequences of the failure to improve the infrastructure in the reconstruction phase became noticeable in the form of bottlenecks in this sector. Here, too, considerable funds were required to cover even the most urgent demand for infrastructure investment.

The consequences of these factors, which together led to an unmistakable deterioration in the economic climate, were not sufficiently recognized at that time.

4. A Slowing in the Advance of the Social Market Economy

A. Müller-Armack had developed the concept of the «Social Market Economy» as early as the Forties and had worked out the essential points of its original programme. In the years 1957–1962, he again published a series of articles which contained detailed proposals concerning, on the one hand, a business-cycle policy which corresponded to the changed conditions and, on the other hand, the expansion of social security provisions in the market economy. It suffices here to mention his code of business-cycle policy with its general principles and rules of behaviour in specific economic situations as well as his proposals on

capital formation in wide sections of the population, on promoting educational policy, on improving public health welfare and also on systematically tackling the environmental problems that were already making themselves felt at that time.

These articles, in which he worked out answers to detailed questions, presented an opportunity for the Social Market Economy to move into a second phase; this opportunity was, however, hardly grasped. With the departure of *Erhard* and *Müller-Armack* from the Ministry for Economic Affairs, there ensued in this field a vacuum in which the battle between organized groups began increasingly to gain the upper hand. Economic policy got out of control. Social conflicts became more serious. Hardly any more «reforms for improving the system» were carried through (if one excludes individual items like the beginnings of capital formation policy and the extension of the social insurance system). Following the first one and a half decades during which the Social Market Economy had been actively promoted, a gradual slowing-down process took place. This development must be taken into consideration if one wishes to understand why so many advance laurels were bestowed on the Stability Act at the time.

II. The Experiment of Demand Management

1. The 1967 Stability Act as the Start of a New Experiment

In 1964, the Federal Cabinet under Chancellor *Erhard* decided to prepare «legislative measures to influence economic development». As a result, the Cabinet passed the «Bill to Promote Economic Stability» in mid 1966. In the course of the parliamentary discussions, the draft of the Stability Act was modified in essential points, whereby the SPD's ideas of the time prevailed. In comparison with the original draft, the Act was extended to include economic growth and was then accepted by Parliament in May 1967. At the same time, Article 109 of the Bonn Basic Law (Federal Constitution) was changed so as to create the constitutional prerequisites for an extension of financial policy. The «Demand Management» experiment now got under way.

When the Social Market Economy was introduced in 1948, there were many sceptics – including above all economists. Only the success of the experiment silenced the critics.

In the case of the Stability Act, the situation was precisely the opposite. Rarely have so many laurels been heaped in advance on a basic change in the direction of economic policy. The majority of German economists believed that this Act represented the «rationalization of economic policy» they had been demanding for so long. It was widely held that the Federal Republic of Germany was now equipped with the finest set of economic instruments in the world. There was even talk of the «procedural Basic Law of the market economy», and it was further claimed that one was now dealing with an «enlightened» market economy – as opposed to the previous «naive» market economy.

Despite the general euphoria, even then warning voices could be heard about exaggerated expectations. In this respect, the sceptics were not only referring to various absurdities in the Stability Act. They also predicted that, whilst the new instruments made it possible to slow down a cyclical downswing and initiate a new upswing (all the more so since it basically involved the old Keynesian recipe), the «moment of truth» would come when one had to tame a boom.

The small band of critics were to be proved right. The highly praised «rationalization of economic policy» should therefore be taken with a pinch of salt.

2. The Asymmetrical Effectiveness of Demand Management

Initially, however, the events of 1967 and 1968 seemed to justify the «advance laurels». Within a year, the economy succeeded in extricating itself from the recession – by means of a massive combination of financial investment programmes and incentives with a corresponding cheap money policy. The positive assessment of the Stability Act appeared to be confirmed.

Today, however, we are in a position to assess the effectiveness of this law over a longer period of time. Generally speaking, it can be said that Demand Management has not passed the test as a new experiment in economic policy. What the sceptics feared from the outset has come true. The aim of «tailor-made growth» has not been achieved. Demand Management did indeed function in a short expansive phase when the main priority was again to achieve the full utilization of capacity. When faced with the self-induced problems of the boom situation, however, the new policy did not fulfill the hopes placed in it. As early as the end of 1968, the difficulties of safeguarding the economy from external influences began to make themselves felt, difficulties that have since cropped up time and again. The revaluation, which had really become necessary early in 1969, was delayed until after the 1969 Bundestag elections, when it was already too late and an adaptive inflation had already exercised its impact.

The ensuing development may, at the risk of over-simplifying, be characterized as hectic movement backwards and forwards between various measures; this was caused by a state of affairs in which the evil spirit of deviation from objectives cropped up now at one corner and then at another corner of the «magic square», and this led to repeated corrective adjustments in economic policy. These hectic fluctuations were, however, also induced by considerable divergencies between economic forecasts and by the effectiveness of many instruments being either overestimated or underrated.

This resulted in inflation rates and disequilibria both on the labour market and in the balance of payments which fare relatively badly in terms of economic efficiency when compared with the previous Social Market Economy experiment. The Stability Act generally proved to be asymmetrically effective. With the aid of this law or rather with the possibilities it opens up, it is easy to step on the accelerator, whilst the brakes in the «business-cycle automobile» do not work satisfactorily.

This leads of course to the question as to the reasons for this failure. If one proceeds on the assumption that economic policy – like any policy – contains three constituent elements, which are usually termed situation, aims and instruments, then it is possible, in the light of these three elements, to point out several essential causes of the unsatisfactory working of the Stability Act.

3. The Excess Demands Made on Situation Analysis

The problems begin with situation analysis. In contrast to the business-cycle policy in the Social Market Economy, which acts in a responsive way to diminish fluctuations in the business-cycle, Demand Management seeks to actively «manipulate» the development of the business-cycle. To characterize this difference, one used to speak of compensatory and anti-cyclical policy. In practice, however, there was hardly ever a clear-cut division between these two concepts. The institutional inhibitions in the process of decision-making alone, as well as the delay before these measures took effect, led to the compensatory element of business-cycle policy always being the more important.

However, if one wishes to consciously influence the development of the business-cycle in an anti-cyclical manner (and the Stability Act makes this claim), then there is much greater need for information. It must be possible to assess the situation, and in particular its future

development, to at least a fair degree of reliability. The success of policies depends, therefore, on the quality of the forecasts upon which they are based.

Despite all the efforts of the experts to perfect forecasting methods, there has hitherto been little success in improving the quality of forecasts in a way that is lasting enough to enable the creation of the prerequisites in the field of situation analysis necessary for more effective policies. Comparisons between forecasted and actually realized figures reveal in some cases such large divergences that the low quality of forecasts alone is enough to show that the results expected from Demand Management were exaggerated. The frequent divergence of opinions among economic researchers in their assessment of the situation points in the same direction.

One essential cause of the excess demands made on situation analysis can be seen in the extreme flexibility of the market economy. Adjustment reactions to changes in exogenous factors can ensue relatively swiftly, with corresponding consequences for the forecasts. Industry can, for example, postpone or stretch the time scale of investment plans (with all the consequences this has for suppliers as far back as the steel industry).

As a general rule, one can say that the computability of the future is usually overrated by the advocates of Demand Management. This in itself reveals an important conceptual difference between the two experiments. Demand Management is to a certain extent subject to a compulsion to forecast. It is forced to quantify the future, because otherwise no macroeconomic objectives can be fixed. The Social Market Economy represents an open system in contrast. This does not mean that the Government should not make forecasts in the Social Market Economy system. Budgetary and financial plans alone make it necessary to make quantitative assumptions on the development of the economy. The difference lies in the fact that, in the Social Market Economy, such projections only represent «guidance data» for the public sub-system of the economy, whereas in Demand Management they are also applied to the private sub-system. The more they are discussed, the more likely the economic entities are to gear their actions to them. The forecasts are then no longer neutral in terms of behaviour.

4. Problems in Formulating Aims

When one examines the aims themselves, the differences become clearer. The basic aim of Demand Management, namely macroeconomic equilibrium, which is embodied both in the constitution and in the law, has provoked criticism above all in the legal field. A concept of economic theory, which in that context is certainly justified, is translated in practice into economic reality, which – particularly when observed from the equilibrium perspective of the theory – proves to be a continuous process of disequilibrium. The economic interactions are characterized by continuous endogenous and exogenous impulses which lead to ever new adjustment processes. As an objective of economic policy, macroeconomic equilibrium does not fulfill the condition of operability. In legal respect, it lacks *justiciability*. Macroeconomic equilibrium thus belongs to the category of «indeterminate legal concepts». The obligation placed on the Federal and Länder authorities to take account of the needs of macroeconomic equilibrium cannot be verified by law. The complications for a constitutional State that result from this should not be underestimated.

The aims of macroeconomic equilibrium are, however, also full of problems. § 1 of the Stability Act prescribes the «stability of the price level» as the guiding principle of activity in the field of economic policy; according to § 2 of the same Act however, the Federal Government must quantify the aims in its Annual Economic Report, i. e. in this case, it must state a rate of inflation. Here, we immediately see the Rubicon between the Social Market Economy and Demand Management. The advocates of the Social Market Economy in both political and scientific circles have always rejected quantified target projections of this kind.

Ludwig Erhard in particular always passionately resisted making the aim of price stability a relative matter by officially announcing a particular rate of inflation for the coming year. For such predicted rates of inflation have a habit of fulfilling themselves, because they are also believed – since they are announced by the Government – and those involved in economic activity adjust their behaviour accordingly. Because of this tendency of forecasts to be fulfilled, the original draft of the Stability Act did not prescribe any such quantifying of aims. It was only included in the final version of the law because of the demand of the SPD.

The second aim is formulated as a 'high level of employment'. That would be perfectly all right if this aim did not also have to be quantified in the Annual Economic Report. The average unemployment rate for the year is quoted here and this is assessed at such a low level that, in practice, overemployment is postulated as the objective. Despite the findings on the relations between the rate of inflation and the level of unemployment arrived at in the discussion on the Phillips curve, the unemployment rate is fixed so low that it tends to cause a conflict of aims to the disadvantage of price stability. Contrary to the text of the Stability Act, according to which the aims are all of equal importance, the aim of a high level of employment is thereby virtually recognized as the first priority. This also results from the 'full employment guarantee' given by the Government on several occasions.

The third aim of 'balance of payments equilibriums' also involves difficult tasks for Demand Management. What individual items in the balance of payments should be subject to quantified aims and how high should these be? Should balance of payments equilibrium be defined in the short, medium or long term?

According to the text of the Stability Act, the three above-mentioned aims should contribute to a 'continuous and appropriate rate of economic growth'. Growth must therefore also be quantified in the Annual Economic Report. Here again, opinion is divided into two camps. For the advocates of the Social Market Economy, economic growth can only be the result of millions of microeconomic decisions. If growth rates of GNP are forecasted for development in a market economy, then that is tantamount to putting the cart before the horse, as the Norwegian *Ragnar Frisch*, who later became a Nobel Prize Winner for Economics, both drastically and appropriately put it in 1964. In the meantime, people have realized that what is important is not mere growth rates alone, but rather the qualitative composition of this growth, the 'quality of life'. If the quality of life has become a problem, then that is not least the result of quantitative growth fetishism. The human being is simply incapable in the long run of enduring 'still more', 'bigger still', 'faster yet', etc. . . .

5. Weaknesses of the Instruments

In order to realize aims, one needs instruments. The extension of the economic policy instruments may be regarded as a particular achievement of Demand Management. Unfortunately, the improved possibilities of economic policy were widely linked with the belief that more could also be achieved with more instruments, particularly more effective policies. As has since become clear, more instruments alone are not enough. The decisive factor is how they are handled. At this point, let us mention just three weaknesses in the set of instruments which highlight the problematic nature of Demand Management particularly clearly.

The first of these weaknesses lies in the safeguarding of domestic economic policy from external influences. One reason for this is to be found in § 4 of the Stability Act. According to this, measures to protect the economy from outside influences can only be taken if

1. external disturbances have already taken place (which implies a return from the anti-cyclical principle to the compensatory principle);
2. the internal means of defence do not suffice;
3. the alternatives of international cooperation are unsuccessful.

This wording leads one to the conclusion that the protection of the economy against

external influences was not originally given a very high priority in the general concept of Demand Management. In the meantime, opinions on this subject in particular have changed.

The international ties, which the instruments of foreign trade policy are subject to, constitute a further cause of the «hole at the border». Suffice it to mention here the EEC and the IMF. Only when there is an economic and monetary union in the EEC with a single, flexible exchange rate can the problem of external safeguarding be solved for this economic area.

The second weakness in the set of instruments of Demand Management that should be mentioned here is the Concerted Action. Since it was based on the wrong premises, and in particular on a Rousseauist picture of human character, it was bound to fail. The same problems arose here that have come to light in all attempts at incomes policy hitherto, in so far as they are based on moral suasion, income, guidelines, guidance data and the like.

Finally, the third weakness which has repeatedly come to the fore is the lack of coordination between the centres of decision-making. Considering the countless coordination problems unavoidable under a polycentric economic policy, it is astonishing that progress in this context was been limited to a few, somewhat unpromising beginnings. The Concerted Action is little more than a communications exercise between several autonomous groups and the State. The Public Authorities' Economic Council can, for constitutional reasons, only exercise an advisory function for the Federal and Länder authorities. Medium-term financial planning also only functions more or less haphazardly as a coordinating instrument. The problem of lack of coordination between the centres of decision-making can probably only be solved by a fundamental reform of the institutional structure of economic policy-making.

III. Critical Assessment of the Demand Management Experiment

1. Attempts at Explaining the Failures of Demand Management

The fact that our experience of Demand Management has so far been negative is not even disputed by its advocates. The question of the causes is, however, controversial. For the difficulties are not only manifested in the above-mentioned inflated expectations of situation analysis, the problems of formulating aims and the weaknesses of the instruments. The actual reasons lie deeper. Several attempts have been made to provide a satisfactory explanation.

One of these consists in attributing the weaknesses of Demand Management to exceptional factors. Such factors have certainly had an influence. The most important factor in this context is the euro-dollar market, which swamps the European countries with its thousands of millions of dollars etc. like a spring tide. The dikes that have been erected to control it are emergency measures and furnish only a partial help. It must, however, be pointed out that the solution of the euro-dollar problem represents a necessary precondition for a successful stability policy.

A second attempt at an explanation employs the *ad personam* arguments and states that the causes lie with the politicians. Supporters of this view are of the opinion that it is not that the instruments of Demand Management have failed, but rather that their handling by the responsible politicians has been inadequate. Of course, one can always say afterwards what could have been done better. In this respect, one should, however, bear in mind that in a parliamentary democracy the concrete decision-making processes are extraordinarily complex and to a large extent determined by the respective institutional and political circumstances. Party political considerations and election tactics play a not inconsiderable role in this respect.

The third attempted explanation proceeds from the possibilities that the Stability Act itself offers and confronts this with what would be necessary in order to solve the continuous flow

of new and different problems. This results in the call for a further improvement in situation analyses and above all in the instruments. There has been agreement on the need for a revision of the Stability Act for some time. Corresponding proposals are already available and are under discussion.

In addition, these three attempted explanations certainly do not always occur separately. They are in fact mostly combined with each other, e. g. according to the formula: conditions must be improved, the politicians must improve and the legal foundations must also be improved. This certainly touches on some of the essential causes of the weakness of Demand Management hitherto.

However, if these problems were mastered (assuming that this is possible at all) that would only slightly improve the chances of more efficient policies. For the above-mentioned attempted explanations merely scratch the surface of the problem. The expectations placed in Demand Management are, in the long term, simply too high, although short-term successes are, as experience has shown, certainly possible.

A critical assessment of the Demand Management set experiment which goes beyond superficial deliberations must therefore dig deeper and include the theoretical concepts upon which Demand Management rests. Suffice it to touch on just three aspects here, namely

1. the neglect of the development of money supply,
2. the «historical anthropomorphism» of macro-relations,
3. rationalist constructivism.

The first two aspects characterize certain erroneous developments in economics, the third refers to the socio-philosophical principles of the Demand Management experiment.

2. Neglect of Changes in Money Supply

As far as the ideological background is concerned, Demand Management evolved from the «Keynesian revolution» which, for its part, may be understood as a scientific answer to the experiences of the World Economic Crisis. At that time, fiscal policy measures to stimulate the economy were perfectly consonant with objectives; on the other hand, traditional monetary policy failed.

In the course of developments after the Second World War, however, the Keynesian position became increasingly limited to «fiscalism». The importance of monetary policy was rated progressively lower, the role of financial policy, on the other hand, progressively higher. In the end, several advocates of this position expressed the opinion that the total demand of the economy created the necessary money supply of its own accord. Hence, it was claimed that it was not monetary policy that was required, but rather a fiscal steering of total demand. The money supply disappeared, as it were, from the field of vision of the fiscalists and from that of the politicians who followed them. The result was that, in the last decade, annual increases in the money supply of 15 to 20% were by no means rare in some countries. The consequence was initially «creeping» inflation, followed by «galloping» inflation. Yet the hydra of inflation continued to be fought with instruments of financial policy and later on with direct controls (wage and price freezes). As is so often the case with mere symptom therapy, this only aggravated the illness.

As everyone knows, revolutions devour their own children so that the result in the field of economics was a «monetarist counter-revolution». The monetarists wanted the steering of the money supply to replace the influencing of total demand exclusively by fiscal policy. With occasionally dogmatic exaggeration, the money supply was now proclaimed to be solely responsible for the business-cycle fluctuations. The proposal about tying stability policy more strictly to the rules – to replace the previous discretionary decisions of the economic policy-makers – provoked the most discussion.

The controversy between monetarists and fiscalists is still in full swing. With respect to the

Demand Management experiment, which was carried out in both theory and practice by the fiscalists, it has at least shown that the neglect of the money supply was a fundamental mistake. The form of Demand Management hitherto applied is therefore based on theoretical concepts which no longer apply to a changed reality. The Social Market Economy, on the other hand, was essentially characterized by the ideas of neo-liberalism and thus rested on theoretical principles which were different in important aspects.

The old truth that, in the long run, no inflation will occur unless it is financed by an increase in the money supply is the central problem of stability policy. The extent to which this fact has been suppressed is amazing. The transition from «creeping» to «galloping» inflation, which has already taken place in many countries, has recently led to politicians apparently «rediscovering», the importance of the money supply.

Only on the basis of a longer-term steering of the money supply which does not anticipate real economic possibilities will a short-term business-cycle policy have any chance of success. In this context, financial policy instruments will then also have their place. The dispute between monetarists and fiscalists can thus be solved by connecting in series short-term business-cycle policy based on financial policy measures with the more long-term steering of the money supply. If agreement were to be reached here, then a consensus would more easily be reached in the detailed questions, which are themselves difficult enough to solve. The crux of the matter is thus not to replace fiscalist exaggerations by monetarist exaggerations, but rather to assign each concept its appropriate place.

3. Macro-Relations, or the Danger of «Historical Anthropomorphism»

Apart from the neglect of the money supply as an expression of an extreme fiscalist Keynesianism, the economic conclusion drawn from the distinction between micro- and macro-relations was also dubious. By this we mean the opinion that the principle of control by the market of micro-relations can, without contradiction, be combined with the principle of demand management of macro-relations.

But what are in fact macro-relations? They are conventionally defined as relations between aggregated data. These come into existence by the concentration (in a simple case by addition) of countless micro-data which result from millions of decisions by individual consumers, enterprises and public bodies. The concentration of micro-data to form clear aggregates and further to form a total – i. e. the gross national product as an expression of the economic activity of a country – is highly useful for economic and didactic purposes. The economic circulation which is otherwise not at all transparent, is thereby clarified, albeit also simplified.

The distinction between micro- and macro-relations is, however, harmless as long as it remains clear that macro-data – in a qualitative sense – always remain a total. There is no way in which this intellectual aggregation can become independent and therefore something qualitatively new.

The fact that the aggregation of microeconomic data is an intellectual operation which cannot produce a collective unit representing a new reality is really self-evident. Well-known economists have been drawing attention to this methodological boundary of aggregate analysis for a long time and have also warned of the dangers that may ensue from employing mere intellectual experiments in economic policy. A. Stobbe for example writes: 'Aggregation is nothing more than a calculation operation carried out on the economist's or statistician's desk, an operation that does not change reality in the slightest. It can never mean that the aggregated economic entities suddenly begin to act with a common will. (A. Stobbe, «Volkswirtschaftliches Rechnungswesen» [National Accountancy], Berlin, Heidelberg, New York, p. 45 et seq.).

The theory of Demand Management, however, proceeds on the basis of precisely this

fictitious idea that macro-data are independent collective economic entities whose behaviour can also be influenced by economic policy. Thus, an image of reality achieved by intellectual abstraction itself becomes reality. Reality is firstly translated into a symbolic language with which logical operations can be carried out. Then, the results of this are translated back into reality. The point overlooked in this process is that the microeconomic reality is not changed in the slightest by staging macroeconomic intellectual exercises with it. It is nothing more than a myth that a fictitious reality can be steered by economic policy. For only real behaviour – and this always means the behaviour of microeconomic entities – can be the starting point of economic measures.

However, this myth seems to be inherent in man's psychological make-up. For even as early as in the works of *Karl Marx* (who, as the ideological forerunner of modern circulation analysis, himself used macro-relations in his theoretical work) one finds massive and ironic criticism of this example of pushing a method beyond its limits. «*Mr. Proudhon* is not satisfied with wiping out from supply and demand the elements we have mentioned. He carries the abstractions to extremes by welding all producers into a single producer and all consumers into a single consumer, and leaves the battle between these two chimerical persons to sort itself out. In the real world, however, things happen differently.» (*K. Marx*, «*Das Elend der Philosophie*» [The Misery of Philosophy], Stuttgart 1885, p. 15).

Between the two World Wars, it was the Dutch historian *J. Huizinga* who referred to the general tendency of man to «look at an intellectual whole as if it were capable of actions or patterns of behaviour that seem to assume human consciousness». *Huizinga* termed this tendency «historical anthropomorphism» and pointed out the dangers that can result if the political creative will exaggerates the mythical character of fictitious realities.

From here, it is then only a small step to *E. Böhlers* analysis of myths in the economy and society. In this respect, *Böhler* goes much further than *Huizinga* in that he attributes the creation of myths to psychological processes that blind the human being to what really happens.

It could only be as a result of the mythical conception of macro-relations that many economic politicians nowadays regard the economy as a kind of vending machine into which one inserts a policy measure at the top so as to receive the desired result below in the form of a change in individual behaviour. It all depends on pulling the «right lever».

The myth of the demand management of macro-relations is thus combined with false assumptions on the behaviour of economic entities. Whilst the science of microeconomics has – according to detailed empirical studies – long since moved away from its previous fictitious assumption of profit maximization as the sole objective of efficient behaviour, Demand Management, untroubled by the progress of science, proceeds on the assumption that economic entities, i. e. the microeconomic units, react uniformly to particular changes in the economic data. For only on such an assumption can one argue that individual behaviour may be «manipulated» at will in an expansive, a contractionary or any other desired direction. Of course there are economic entities which adjust their behaviour in the way expected. But there are also others which do the opposite. A great lament is then heard about economic policy measures being thwarted. Scapegoats are sought – like, for example, the «evil speculators», or the investors or whatever – so as to veil the true reasons for the failure of policies.

A closer examination shows that the history of economic policy is also the history of undesired side-effects. The true picture of behaviour in the microsector is characterized by evasive action and resistance by the economic entities affected, and this again and again restricts the creative will of politicians. Why is this? Because measures are taken without there being any real knowledge of what effect they have in individual cases. In practice, our knowledge of the major effects and side-effects of economic policy instruments is still very limited. Despite all advances, above all in econometrics, forecasts of the effects of particular measures cannot be made with the necessary degree of reliability. Forecasts of probable

effects made on the basis of ex post data assume the stability of these ex post data; in practice, however, the parameters upon which the forecast is based can in turn also be influenced by subsequent developments. One only knows afterwards whether, for example, a tax increase will really lead to the desired restriction of consumption. The taxpayers can – especially when there is an advanced inflation mentality – also maintain their consumption by dissaving or by going into debt. Similarly, it is not irrelevant for a forecast whether a measure is limited to a fixed period of time or not. The reactions of those affected can be completely different in each case. Individual behaviour is still the great unknown in economic policy. In the game of «the public team versus the private team», the private players tend to behave rationally and the public players, on the other hand, irrationally.

If the theoretical concepts upon which Demand Management is based were really accurate – i. e. if they accurately explained what happens in the real world – then it would also have been possible to use it to pursue more efficient policies. But the macro-relations have been mythologized and too little is known about micro-relations . . .

4. The «Enlightened» Market Economy – An Expression of Rationalist Constructivism

The Social Market Economy experiment was exposed to a slow process of erosion, the main reasons for which were of a political nature. The chances of a Second Phase of the Social Market Economy could no longer be utilized because of the increasing influence of organized groups. The causes of the failure of the demand management experiment lie, however, in the intellectual field. The economic policy-makers based their decisions on theories that were false, or at least no longer consistent with present-day reality.

But how is it possible that in 1967 an Act came into being which was praised as being the «Basic Law of Economic Policy» of an «enlightened» market economy and which carried within itself from the outset the seeds of its own failures? The term «enlightened» indicates where to look for the answer to this question. In the way it was conceived and practised, Demand Management is a typical example of the application of rationalist constructivism.

The first to fall for the fascination of rationalist constructivism were the majority of economists, followed by the politicians. They undoubtedly did this in good faith and believed they were marching in the van of scientific progress. For there is hardly a single technical term that has enjoyed such popularity in the last few decades as that of «rational policy».

All those looking for the sources of the failures of Demand Management, who expect the problems to be solved by extending the set of instruments, also undoubtedly do so in good faith. As long as the constructivist basis, the conviction of «being able to make anything», is not clearly recognized, all these efforts will, in the final analysis, also be condemned to failure.

We are again indebted to A. Müller-Armack for providing basic insights into these relations; in his works in the Thirties and Forties on the sociology of religion and culture, he revealed essential determinants of the development of the modern industrial society. We are particularly indebted to him for showing the extent to which the secularization of beliefs has made its mark on the industrial age and how calvinist, lutheran and catholic beliefs have led to the creation of different forms of economic organization.

In the Fifties and Sixties, it was then above all F. A. von Hayek who shrewdly analyzed more and more new aspects of the socio-philosophical foundations of a liberal order. The response to his main work, «The Constitution of Liberty», published in 1960, is still growing steadily. Coming generations may possibly regard Hayek's «Constitution of Liberty» as the most important socio-philosophical work of the 20th century. It may also initiate a renaissance of thought on regulative principles which is universally losing favour, particularly under the impact of Demand Management.

Thanks to the studies carried out by A. Müller-Armack and F. A. von Hayek, we are now in a position to recognize the intellectual roots of the economic malaise of our time. These roots reach back to the 17th century – if we restrict ourselves to modern times – and were already fully developed by the 18th century. Its most important ancestor was Descartes, who supported the view that man plans all his institutions and actions in a rational way with a clear knowledge of their main effects and side-effects and can therefore change them at will. This cartesian approach widely asserted itself in the French Enlightenment against English social philosophy (*D. Hume, B. Mandeville, A. Ferguson, A. Smith*, inter alia) and managed to push the development of liberal thought in the direction of French rationalist-constructivism. The empirically and evolutionarily oriented thought of the English tradition was no match for the belief in reason and the possibility of planning development, which involved such concessions to human vanity. Hence, there is a direct line of descent from *Rousseau's* Social Contract via positivism and the socialism of the 19th century to the pragmatism of our times. The fundamental difference between the English and French roots of liberal thought is hardly recognized any more and, despite their totally different approaches and conclusions, both are «grouped together»; this is not only a result of the greater fascination of rationalist constructivism, but also of the fact that in France, *Montesquieu, B. Constant, A. de Tocqueville* and several others belonged to the empirical-evolutionary British Tradition, whilst in England, *Th. Hobbes, J. Bentham* and a whole group of lesser spirits inclined towards French rationalism.

The Demand Management experiment is only one of the many forms of expression of rationalist constructivism which descend from the French Enlightenment tradition. The term «enlightened» market economy speaks for itself. The Concerted Action, hitherto an essential component of Demand Management, has interestingly enough also been called a reprint of the «Contrat Social». The constructivist cloven hoof thereby comes to light – albeit probably unintentionally: *Rousseau ante portas!* Is there not therefore food for thought in the fact that today the late-marxist «New Left» also enjoys quoting *Rousseau* so much?

5. The «Keynesian Message» or the «Freiburg Imperative»?

The discussion on the weaknesses of the demand management experiment has hitherto hardly advanced to these roots of philosophical history. The solution is rather sought in the above-mentioned exceptional factors, and it is believed above all that more can be achieved with more instruments. An essential reason for this narrowing of the field of vision, which mistakes symptoms for causes, lies, in our opinion, in the view that Demand Management constitutes a combination of the «Keynesian message» and the «Freiburg imperative». The «Keynesian message» is applied here to the steering of macro-relations by means of the Stability Act and the «Freiburg imperative» to the steering of micro-relations through an efficient competition system.

Walter Eucken, who is quoted whenever the slogan «Freiburg imperative» is used, would – one may doubtless assume – have been vehemently opposed to this combination with the «Keynesian message». His «Principles of Economic Policy», which appeared posthumously in 1952, reveals that he took a keen, but also critical interest in *Keynes*. On p. 27, Eucken states that Keynes did not understand the major importance of the fundamental idea of laissez-faire economic policy. On p. 350, Eucken equates the Keynesian concept that the State must carry through the common good as opposed to the self-interest of the economic entities with mercantilist views, especially those of Colbertism (similar statements are also made on p. 361).

With respect to his own concept of competition regulation, i. e., the «steering of the microrelations», Eucken repeatedly disassociates himself from Keynes (e. g. on p. 236 and

very clearly on p. 244). On p. 230 et seq. Eucken speaks of «fictitious economic problems» and mentions amongst other examples the «basic concept, influenced by Keynes, of full employment theory and full employment policy».

Eucken states expressly that the concept of a stability policy oriented toward the market economy system must not be confused with Keynesian full employment policy¹¹. *Eucken* had at that time already clearly recognized what lay behind the «Keynesian message», for, in three different passages in his work, he compares Keynes' thought with the socialist proposals of *W. Rathenau* and goes on to stress *Keynes'* Rousseauist picture of human character.

Anyone who, on the other hand, takes the trouble to read *Keynes'* two main works in this light will find sufficient evidence for *Eucken's* criticism of the «Keynesian message». For example, in his «General Theory of Employment, Interest and Money», *Keynes* writes: «I conceive, therefore, that a somewhat comprehensive socialization of investment will prove the only means of securing an approximation to full employment; though this need not exclude all manner of compromises and of devices by which public authority will co-operate with private initiative . . . Moreover, the necessary measures of socialization can be introduced gradually and without a break in the general traditions of society.» The most revealing aspect of this quotation is the fact that *Keynes* – in contrast to today's advocates of Demand Management – clearly saw the consequences of his concept. Since intellectually conceived macro data and relations cannot represent a basis for effective policies (only measures that affect micro-behaviour are effective), the overall projection must be split into areas, sub-areas etc. in order to induce a form of behaviour on the part of investors that conforms to the projection. In the case of the French central planning experiment, this consequence of overall investment aims was fully recognized. A differentiated system of positive and negative incentives, as well as the legal institution of the planning contract, aim at inducing enterprises to carry out the investments planned from above.

In the foreword to the German edition, *Keynes* remarks that his teaching – i. e. what today is called the «Keynesian message» – «could be adjusted to fit conditions in a totalitarian state much more easily» than those in a market economy. That this statement is by no means a compromise in the light of the political situation in Germany at that time is proved by an extremely remarkable passage in his work «A Treatise on Money» of 1932. As early as this, *Keynes* wrote: «In a Socialist system which was directed with perfect knowledge and wisdom, the diversion of productive resources could be effected by fiat.» The combination of the «Socialist system» with «perfect knowledge and wisdom» that *Keynes* makes here is again a clear reference to rationalist constructivism, to the engineer's way of thinking as a decisive intellectual root of the «Keynesian message».

An engineer develops a machine rationally. And, if he has not overlooked anything, it also works. Economic constructivism does not, however, deal with machines but with human beings. They act according to their own individual interests, depending on how they interpret these interests in each concrete case. Hence, if one supposes that their action is governed by a «sense of economic responsibility» and by a «knowledge of the common good» and that they act in an «enlightened» way as «mature citizens» etc., then one is expecting too much. Those who argue on the basis of collective reason à la Rousseau proceed from an over-optimistic and therefore false picture of human character. More than half a century ago, the famous «system-changing reforms» were carried through in the Soviet-Union. The «new socialist man» who should have emerged as a result has still not arrived on the scene . . .

IV. Comparison between the Conceptual Elements of the Social Market Economy and Demand Management

The above observations represent an attempt to clear up the widespread misunderstanding that the Social Market Economy has a quarter of a century of continuous development behind it, and that in this respect the system of Demand Management practised since 1967 is simply a consistent continuation and improvement of previous policy – an advance, as it were, from the «naïve» to the «enlightened» market economy. As was stated at the outset, it is, on the contrary, a matter of two different experiments, even if this fact is concealed with regard to the second experiment – above all by the constant solemn declarations of the politicians.

In conclusion, we should like to stress again the differences between the two experiments by means of a comparison between their conceptual elements. We shall limit ourselves to the basic regulative principle, the aims, the instruments and the dominant intervention criterion.

The basic regulative principle of the Social Market Economy is freedom of the individual. Only in competition with others can the individual develop freely. The creation and safeguarding of competition is therefore primarily a means of protecting the individual. The social component of the market economy was originally understood in the sense of a social security policy. In the second phase of the Social Market Economy, which was conceived by A. Müller-Armack but no longer put into effect, the emphasis would have been laid more on guaranteeing the social prerequisites of free development.

The basic regulative principle in Demand Management is, by contrast, more difficult to define. Whilst one does find in the list of aims in the Stability Act the phrase «within the framework of the market economic order», the Act itself and above all its application shows that the conditions of the functioning of a market economic order were apparently not properly understood. The understanding of transformation tendencies of the economic order was already blocked. The phrase «within the framework of the market economic order» fulfills increasingly an alibi function. In our opinion, the conviction of «being able to make anything» can best be taken as the basic regulative principle of Demand Management: «Everything can be made, all one needs is the right maker to come along». Competition becomes instrumentalized so that it no longer serves primarily the free development of the individual, but rather the achievement of certain economically desirable results in the market. Individuals are granted «degrees of freedom» that can be varied at will according to the ideas of the respective economic policy-makers. Economic and structural development becomes a state monopoly. This «concept of being able to make anything» is also behind the increasing decline in the rule of law, which is manifested in the intermingling of public and private law, particularly in the tendency to employ private law as an instrument to achieve economic aims.

The conceptual difference between the two experiments stands out even more clearly with respect to the aims. For the Social Market Economy, the horizon as far as aims are concerned, is quantitatively unlimited. The macro-aims are exclusively declaratory in character (for example, the aim of price stability, which is not made relative by a programmed rate of inflation).

In the case of Demand Management, however, the horizon of objectives is quantitatively fixed. According to § 2 of the Stability Act, the Federal Government must draw up projections for the aims of the «magic square» in its Annual Economic Report. The quantifying of such macro-aims does not, however, represent a further development of the Social Market Economy but rather something qualitatively different. For quantified macro-aims are not neutral as regards behaviour. Rather, they can change the behaviour of economic entities indeed to an extent that is not adequately predictable. This again is an expression of rationalist constructivism, which proceeds from the principle of «being able to undertake anything» and therefore overestimates the scope of prospective situation analysis.

Noteworthy conceptual differences can also be found with respect to the instruments. During the Social Market Economy experiment, the development of the instruments of economic policy was neglected, thus inadvertently promoting the loss of intellectual appeal.

Under the impact of Demand Management, numerous new instruments were created – in itself a positive accomplishment; the problem was that either too much was expected from them, or else they were not handled efficiently enough. Instead, those responsible lapsed into hectic fluctuations between measures.

This development can also be seen with regard to the dominant intervention criterion. The question of whether a measure is consonant with economic aims is, of course, valid for the Social Market Economy – as for all forms of economic policy. But this question always overlaps with regulatory considerations. A measure must therefore not only be consonant with aims, it must also take sufficient account of the criterion of market conformity. In other words, the ends by no means justify the means.

Demand Management, on the other hand, shows a dominance of conformity with the aim. In many areas of economic policy, interventionism has shown a marked increase. Pragmatic and therefore ad hoc thought is on the advance everywhere. Pragmatism is, however, in particular a standpoint that lacks the helping hand of regulative principles. One stumbles from one problem to the next.

What consequences can be drawn from the comparison between the two economic experiments? The advocates of Demand Management never grow tired of stressing that there can be «no return to grandpa's market economy». This statement is correct in so far as there can be no question of postulating a return to the kind of policy that was pursued in the first phase of the Social Market Economy. It is, however, incorrect if Demand Management in its present form of the Stability Act is regarded as the only possible policy:

Is there really no alternative? In view of the present domestic political situation in the Federal Republic of Germany, no concrete answer to this question can be given. The «social welfare function», as it emerges from election results, is more likely – bearing in mind the inflation problem – to lead to the expectation that Demand Management will gradually become Total Control. The fate of the market economy depends, in the final analysis, on whether the politicians retain any desire whatsoever for stability. Considering the failures and mistakes in stability policy, the following pithy statement by *F. A. von Hayek* is more valid than ever: «Governments everywhere and at all times have been the chief cause of the depreciation of the currency.»

Ludwig Erhard proved in 1948 that a change of course can succeed even against the views of the majority of the experts. The fact that the advocates of the Social Market Economy themselves have long been discussing the problems connected with adapting this concept to today's conditions, can be seen as an indication of its internal strength. *A. Müller-Armack* had begun as early as 1957 with systematic preparations for the second phase of the Social Market Economy, which subsequently did not come into effect as a result of the political erosion process. Since then, an ever growing amount of literature has been published, which, in toto, contains a clear alternative to the Demand Management experiment, an alternative that is conceived in market economic terms. A preliminary climax was reached in the publication of the work «Soziale Marktwirtschaft. Manifest 72» (Social Market Economy. Manifesto 72), by *L. Erhard* and *A. Müller-Armack*. It is too early to say whether the answers given in that book to the ideological challenge and the economic and social policy problems of the present and the future will find the kind of response necessary to effect a change of course. For, today and tomorrow, the future is still wide open – as it always has been.

Section IV

The Future of the Social Market Economy

The Future of Our Economic System

Norbert Kloten

1973

It would clearly be a hazardous undertaking to give an account of the many substantiated prognoses on the future of the social sciences. The wide range of statements and observations in this field makes it necessary to choose a clear-cut standpoint and to express a personal view of what the future probably holds for us.

The risk of a faulty judgment dwindles in proportion to the degree of critical objectivity which we achieve in articulating our own point of view. Be that as it may, certain factors militate against such a cautious attitude: the individual inclination towards an intuitive vision and towards the application of academic findings to historic processes as well as the demand in our modern society for orientation and for a description – however speculative – of future trends.

The series of ill-starred prophecies stretches from *Robert Malthus* and *David Ricardo* via the works of *John Maynard Keynes* to the efforts undertaken by contemporary sociologists. Although much of what John Stuart Mill, Karl Marx, Josef Schumpeter etc forecasted has proved to be accurate, no-one can claim to have predicted the real essence of today's social reality. Or, to put it more precisely: nobody succeeded in pointing to those factors destined to mould the future and to set them in proper relation to each other. Hence, the lesson taught us by past history is to exercise due prudence in regard to predictions. The fact that I nevertheless agreed to write on this subject must be seen in the fascination which this subject never fails to exercise. Moreover, the theme is perhaps less wide-ranging than other conceivable wordings in that the question concerns the future of «our economic system» and not simply that of those systems which will come to pass at some time or other.

When examined more closely, this advantage – whether a caprice of fortune or the outcome of deliberate curtailment – soon proves to be less impressive. After all, even predictions on a certain economic structure presuppose a grasping and analyzing of the forces which determine the make-up of the system. These forces have to be pinpointed so that their impact and interaction can be described.

If they involve factors of real substance, that will always alter the existing conditions. As Leibniz once observed, the present is pregnant with the shape of things to come. No social or economic system has a structure destined to last for all time. Every system succumbs to change.

Particular interest attaches to those processes whereby quantity turns into quality (*Hegel*). Where such movements assume definite shape, we can expect major changes in our scheme of things. Where this is not the case, that does not signify stagnation but merely the lack of any sign of a more profound change—at least for us. Among the determining forces (whether acting in parallel or pulling in an opposite direction), we must include politics itself. The business of politicians is to shape the economic system—whether in preserving or in developing it. That implies, however, that prognoses based on the status-quo are fundamentally an unsuitable instrument for our analysis. On the contrary, we are theoretically faced with a gigantic range of potential decisions which we can only hope to grasp in rough outline and never in detail. This range of available options would only become explicit if the vicissitudes of social and economic systems were predetermined in history by virtue of clearly discernible forces. In that case, social reality would be subject to a sequence of phases accountable in terms of certain general or even specific laws.

The result of an application of general historic laws might well be a sequence of phases along dialectic lines. For many people, dialectic thought still remains the most significant method of research for ascertaining in the manner described by *Auguste Comte* how a new situation is emerging at any moment from which the next situation will then take shape. In other words, it is a means of understanding the present in terms of the past and the future in those of the present. But the real issue is this: what forces produce the tension which impels changes in conditions?

One of the solutions offered us is that of historic materialism. This theory views the dialectic contradiction between productive forces and productive conditions as the generator of a historically imperative line of development, leading after revolutionary upheavals to a system under which the contradiction in question will be eliminated.

According to *Friedrich Engels*, however, history will only unfold in determinist fashion as long as man fails to recognize the laws of social development. Once that he has recognized them, man can then direct their impact towards the goals which he has set himself. When seen in this light, man cannot act contrary to history—merely within the bounds marked out by the determining forces of history. For *Engels* and for many others, these forces were first described by Marx. Expressed in crude terms, this doctrine states that the direction taken by human acting must be the right one.

In the Marxist view, the impellents of historic change—when gauged by the consistency with which the effects allegedly befall us—are technological processes involving fundamental changes in market structures or the spectrum of social and economic decision-making i. e. operations which have been defined in recent interpretations as «motorial forces». Any theories proceeding from this basis invariably comprise elements of a watered-down historic materialism in more or less clearly discernible form. Such a doctrine explains the transformation of the existing economic order primarily in terms of the situation in the economic sphere, though without resorting to dialectic methods à la *Comte* or *Marx*.

A good example may be found in *Schumpeter's* brilliant book on «Capitalism, Socialism and Democracy» in which the author attempted with the resources of modern economics and sociology to draw an as yet unrivalled, but nevertheless unconvincing overall picture to justify what *Marx* had failed to explain in his writings.

A further example is the convergence theory. That theory by no means postulates strict and inherent laws. On the contrary, it points to certain trends. Despite all the technically, organizationally and/or economically justifiable constraints, there still remains considerable scope for action and manoeuvre. The proponents of the convergence theory expect the free market economies to carry out more centrally controlled planning and the planning

procedures themselves to become more sophisticated. Furthermore, they expect the State to claim a growing share of the national product for itself in order to meet the growing need for material provision, above all through investment in the infrastructure. It is argued that the concentration of industry and the urbanization of society have produced a host of organizational and technical problems such as external effects, which make it necessary for the State to undertake specific governmental activities.

This line of reasoning sees the socialist peoples' republics being forced into a growing measure of respect for basic economic facts and into a decentralization of decision-making and economic action in wide spheres of national life. The call for an optimal social system and a better distribution of the national product necessitates measures and forms of conduct which, in turn, will bring about an approximation of the economic systems. Yet even without accepting the convergence theory in full, many observers believe they can detect an increase in the characteristic features of mixed economic systems – irrespective of whether these are marked primarily by the fundamental aspects of the Western or of Eastern economic system.

A different approach is adopted by *J. K. Galbraith* in his book «The New Industrial State». He sees the new leading class as the managers and technical intelligentsia (techno-structure) in large industrial firms. The requirements of technology and planning have resulted more and more in reducing the influence of shareholders in favour of that of the managers and technicians. Their prime aim is autonomy of planning and action i. e. in particular, independence of the investors and of the State.

Quite a number of scholars believe that the position of private property-owners in Western economies is weakening. They regard the decisive criterion governing modern industrial society as control of production and distribution rather than the private ownership of the means of production. A writer like *Jean Fourastier*, for example, sees a modern commercial enterprise as an undertaking whose main purpose lies in the fulfilment of social functions. The privilege of property is no longer a determining factor for the survival of mankind.

There exists a sharp difference of opinion between those sociologists who interpret the ups and downs of economic systems wholly or partly in a determinist light and those who prefer to regard the economic order primarily as the outcome of human design. Walter Eucken opposes the mystique of the inevitability of development with the argument that the trend in many systems or subsystems «to change into different and often undesired systems does not rule out freedom of choice, but it does nevertheless limit it». Hence, the establishment of economic orders must not be an automatic process. According to Eucken and all representatives of neoliberalism, there is an opportunity under a systematic regulative policy to create the conditions in which viable forms of market coordination and monetary order can flourish.

But this will only be possible if all individual measures intended to shape the economic order (and thus to a large extent the social order, too) are guided by a regulative concept and conform with the chosen system. Economic policy must not be carried out on an ad hoc basis, but remain conscious of the interdependence of subsystems – and therefore also of the longer-term impact of individual administrative decisions on the overall scheme of things.

In this context, we can distinguish two kinds of impact upon the regulative framework:

- the spectacular changes which often take place in or after critical situations (not infrequently evincing the characteristic features of crisis management) such as the Currency Reform in Germany of 1948 or the Economic Stability and Growth Act promulgated in a year of stagnation i. e. 1967 or the present-day attempts to recast the world currency system following the monetary crises of recent years. It is not difficult to realize that such decisions alter the character of a regulative administration.
- the less striking changes, which are only noted as individual phenomena if at all, but which must be expected to exercise an impact on the regulative framework in the medium or long

term. An illustration of this may be seen in the creeping functional changes in property or all those alterations caused by high inflation rates or certain shifts in the sectoral structure of a country's economy.

We shall be taking a closer look at these changes and their potential impact at a later stage. This intention in itself defines my position. For me, the future is not predetermined. As far as the ordering of man's economic and social existence is concerned, he has to rely on his own decisions.

I realize that this observation places me somewhere among the neo-liberals and that my task becomes more difficult rather than easier as a result. But as I have already stressed, the essential thing is to pinpoint the central features in the changes affecting our economic system, the periods of decline and the forces of resistance.

Analysis of the current State of Our Economic Order

In principle, our approach must be a conventional one: to prepare an analysis of our current economic system which will include both a diagnosis and a prognosis. The concomitant problems would be greatly simplified if the diagnosis were to reveal the existence of certain trends and developments in the important sectors of the economy. The next question would be whether the ascertained trends continue to prevail or not. If the question were answered in the affirmative, then we would have to determine the direction and thrust of these trends; and we could then examine whether or not they clash with the general conditions of our economic system.

But if no such «convenient» trends reveal themselves, then we must proceed on the basis of a number of factors of which it can be assumed with a certain degree of plausibility that they exercise a decisive influence on future developments.

These factors fall into two groups:

1. Changes in the conditions of technical production and in the organizational structure of our economic system.

2. Changes in social awareness as expressed, for instance, in the attitude adopted by the political parties and the major social groups to future regulative and social systems.

Any changes in these factors must be examined with a view to establishing whether they exercise an impact on the economic system. These last-named factors possess special significance because the economic order is conceived as the sum total of all rules and institutions. In this sense, the social market economy as a market under «free socialism» was not set up solely by coordinating markets and prices but by coordinating the «vital spheres of the market, the State and the social groups» (*Müller-Armack*). These are the spheres where «social objectives carry an appropriate weight vis-à-vis the economic objectives, thus combining economic with social policy». Hence, one overlooks the social goals of a market economy if one assumes – as *Schröder* does in his *Prognos* study on «Growth and Social Policy» – that this «is only justifiable in that it is expedient for the purpose of growth and fair distribution». If one regards a market economy not merely as a particularly well-functioning solution to the problem of coordination but also demands of it a sense of social responsibility – as under the social market economy – then this involves more than the arrangement of competitive conditions. It entails to an equal degree the pursuance of a stabilizing trade-cycle policy and the corrective adjustment of the results of the market processes, for example by means of an «interpersonal and intertemporal redistribution of income». A market economy also embraces socio-political goals which clash with the optimal economic allocation of resources. *Gäffen* spoke of «social policy acting as a counterfort». In other words, it is conceivable that measures may be adopted which do not conform with the market but which must be regarded as conforming with the system.

We should bear all of this in mind when we pursue our question as to possible future trends and concentrate our attention on three central elements in our economic set-up:

1. The scope and efficiency of market coordination;
2. The significance of private ownership of the means of production and the concomitant powers of control; and
3. The degree of orientation in macro-economic procedural and regulative policy towards the functional principles underlying the market economy.

The question we must ask ourselves is whether the economic system of West Germany, measured in terms of these three criteria, furnishes any indication of changes which are compatible with the regulative principles of the social market economy or whether changes are discernible which go to the very limits of the system and perhaps even transcend them.

Despite the many studies on this subject and the reports submitted by the Federal Cartel Office, little concrete information may be furnished on coordination via markets and prices. There exist far-ranging sectors in which competition has increased since 1948 rather than decreased. This also holds true of foreign trade and international capital transactions (although there has been a setback in the latter in recent times due to numerous additional controls on capital movements). Similarly, it holds true of the housing market which has displayed a general tendency towards liberalization – at least until very recently – despite the many different kinds of intervention practised.

In agriculture, EEC market regulations for farm products have replaced the system of national protectionism. Whether or not this has generated a greater or smaller degree of competition in farming is still a matter for discussion. In my view, there has been more competition (although naturally I have no idea of what would have happened without the replacement of national by European farm policy).

One special cause for concern in recent years has been the growing degree of concentration among commercial enterprises. The regional expansion of the European markets in particular may have exercised a compensatory effect as regards the keenness of competition. Nevertheless, the quality of competition in individual parts of the market and in the market as a whole is undergoing a gradual change. For the time being, however, it is difficult to adduce any evidence.

The difficulty of assessing the quality of competition is also compounded by the replacement of the traditional model of atomistic competition (resting on the assumption of a large number of suppliers and consumers) by the concept of «functioning competition» – for example, as a variant of a wide-ranging oligopoly. But it remains a moot point whether one should measure the quality of competition by its intensity or by its results.

As to the second criterion i. e. private ownership of the means of production, it can hardly be asserted despite numerous complaints that the institution has been curtailed on a much more substantial scale and indeed virtually to the point where this has put the system as such in jeopardy. In principle, it continues to be the mainstay of our type of economy. The existence of certain constraints on the powers of control may be ascribed to the fresh approach now adopted to the roles of capital and labour in the capitalist economic process. Taking a less abstract view, it can be said that the forming and re-forming of groups of factors and to a certain extent the utilization of private property have been circumscribed by narrower limits.

A striking example of this was the revised version of the Labour/Management Relations Act (*Betriebsverfassungsgesetz*) of 10 November 1971. This Law substantially expanded the right of employees to a say, in particular by according works councils a new set of prerogatives. Although the new competences are largely confined to personnel matters, decisions due to be taken in pursuance of Articles 99 and 102 can easily be delayed. The new Urban Development Law of 27 July 1971 furnishes a second example: its provisions substantially limited certain powers of control derived from ownership. Those who deplore this situation should be prepared to offer alternative solutions to the questions about meeting

joint wishes in optimum fashion and reducing random profits accruing from concentration in industry in a manner which conforms with the system.

Let us now turn to the third criterion: the orientation of procedural and regulative policy in accordance with the functional principles of the market economy. Every West German Government since the foundation of the Federal Republic has pursued a policy in line with the basic tenets of a free market economy. Many readers will object to this in respect of certain details and adduce evidence to the contrary. But there is no need in my opinion to correct this central thesis.

The big exception – and one not ascribable to any single Government – consists in the market regulations for the farming sector. As is well known, these can only function if strict conditions are observed. But that in turn renders them questionable in regard to a proper management of public affairs. None the less, these market regulations for farm products constitute not only a national, but also a European and indeed an international problem. From the national standpoint, the regulations entail considerable expenditure and they serve both directly and indirectly to increase the cost of living. Nevertheless, they do not directly generate inflation.

Another illustration – though a less striking one – of a departure from market-economy principles may be seen in the capital market regulations of 29 June 1972. Whilst undoubtedly a product of a critical situation, that does not alter their questionable nature in terms of social order. In part, the capital market regulations operate like custom duties in that they create artificial barriers in the field of interest rates by virtue of the statutory cash deposit on foreign currency credits or the additional minimum reserves for bank deposits placed by foreign nationals. By the same token, they also act as a prohibition or limitation of imports.

These examples and others of similar kind are, however, matched by a large number of remarkable achievements of a decidedly market-economy character. Mention may be made above all of the Restrictive Practices Act of 1957 and, ten years later, the Economic Stability and Growth Act. This piece of legislation assumed great importance because global steering took its rightful place alongside regulative policy in general and competition policy in particular. («Global steering» implies the capacity to regulate macroeconomic constituents such as national income, employment, investment and Government expenditures principally by virtue of decisions on money and credit policy, financial and currency policy).

In the aggregate, there is no denying the meagre achievements of regulative policy in recent years or the even more modest record of procedural policy. Despite years of debate, no progress has been made towards amending the Cartel Law. Although every political party advocates more competition and more price policy (however dubious the latter may sometimes prove to be), no coalition has hitherto proved willing to draw the appropriate conclusions. As far as procedural policy is concerned, we now all appreciate – if only from the weight of our own purses – how heavily inflation weighs upon us. The fact that price stability has almost receded into the distant past must be seen in the context of the durability of overall economic trends awaiting us in the future: the cyclical swings have become more pronounced rather than weaker. This situation has been compounded by the phenomenon of imported inflation against which (for political reasons) no antidote has emerged. Hence, the dynamic thrusts of economic growth and inflation have combined to form an unholy alliance.

In other words, the record is far from healthy. Today, pessimism about inflation reigns so supreme that the various social groups and the political parties alike now tend to accept more and more the inevitability of «relative» price stability (whatever rate of inflation that may imply!). Virtually nobody today deems it possible to return to such erosion rates in purchasing power as would have been regarded as scandalous even a few years ago. The predictions for the new year are of a magnitude which would have engendered an atmosphere of social revolution in the Fifties or early Sixties. Although many regrets are voiced, the opinion seems to prevail that we are constrained in any case to adjust to a high level of

European or international inflation. The habituation to the erosion of purchasing power and the exodus into non-monetary assets continue to increase. The signs of overheating in the house-construction sector flow less from the high degree of income elasticity in the demand for housing (and a rise in national income and thus per capita income results in a keen demand for housing and durable consumer goods in general) than from the efforts to obviate a loss in the value of one's income and monetary assets.

An even more disquieting feature of the current scene is the apparent dwindling confidence in the will and ability of Governments to pursue a policy of stable prices. Such a fading of trust often mirrors the mounting suspicion felt about the efficiency of a market-economy system.

Finally, it must be admitted that numerous changes have occurred in our everyday economic reality and that quite a number of them have justifiably given rise to concern and to criticism of the public administration of our economic affairs. In my opinion, however, the market economy practised in West Germany does not reveal any fundamental changes. On the contrary, we have more market economy today than in the Fifties in the various forms of economic existence.

Two points are worthy of note. One of them has already been mentioned: the doubts entertained about the ability of the State to cope with the problem of currency erosion (whereas the vexed question of unemployment is now regarded as having been resolved in this country). The second item is what I would call the «European Option». In the meantime, a whole series of decision-making processes have passed from national to European jurisdiction. Moreover, there exists an abundance of international provisions which more or less substantially curtail our scope for national decision-making. In consequence, certain major decisions on regulative and procedural policy no longer take place at national, but at European level. Yet as things stand at present, the measures adopted by the European organizations have so far failed to deliver a full substitute for what can no longer be provided at national level. It would seem that the path leading us ahead into our common European future will continue to be marked by flexible interpretation and compromise.

Some Predictions

If our affairs reflect the situation which I have just described, then they do not in themselves reveal any trends towards a profound change in our economic system. But that renders it more difficult to venture on any predictions. But as I have already suggested, the attempt must not be abandoned since other indicators such as the macroeconomic impact of structural, technological and organizational factors or the wishes of the political parties and social groups could help us to achieve our goal.

If we begin by examining the underlying factors in our national economy and the structure of production here, we note that extraordinary changes of every kind have taken place since the Industrial Revolution. Although the bulk of economic activities was to be found in agriculture at the beginning and then later in the industrial sector, the service trades are now assuming ever greater prominence. A fourth sector, known as the quaternary sector, is sometimes added: education and research. Since the composition of the national product alters in line with major groups of products—which cannot be separated from qualitative and quantitative changes in the principal factors underlying the economy—this invariably affects the relative weight of the various sectors and moreover the process of market coordination, too.

Nevertheless, it cannot be alleged that technical, organizational and structural changes of the above-mentioned kind necessarily bring about fundamental shifts in the pattern of the economy. Despite the numerous links which could no doubt be traced, it is manifestly difficult to set up academically tenable theses. Whatever direction an individual trend may

take and whatever form the national product and the underlying factors may assume, it will always be possible to imagine solutions which are primarily of the market-economy type as well as solutions involving a centrally controlled economy.

Thus, our final step is that of ascertaining the goals pursued by the political parties and the social groups. But when we set about doing that, we must eliminate those sources which indicate a determinist philosophy. For them, the future is something which has already been predetermined. To begin with, we must study the party programmes such as the SPD's long-range programme – meanwhile dismissed as a mere hypothetical study – or the much more restrained CDU programmes or the FDP's «Freiburg theses». Consideration should also be given to the reports on social policy drawn up by the German Trade Unions Federation, the German Salaried Employees' Union etc. In this context, it is less important to indicate the divergences in order to show where the parties and groups stand. Such an attempt would in any case encounter a number of snares, since programmes often conceal tactical aims whilst proving on the other hand to be the outcome of political compromise. Of greater significance is the need to filter out from programmes and declarations of intent the parties' common ground. This is where the declared goals seem most likely to attain fruition. By contrast, opposing standpoints tend more or less to paralyze each other in everyday political reality. That has hitherto been the case in co-determination for workers, tax reform and the discussion about statutory savings schemes for employees. Wherever differences of opinion reach their greatest level, the solutions sought in appropriate social policies will take the longest time to achieve. But on what points are the parties and social classes basically in agreement? Briefly, they are as follows:

- Firstly, the increasing scale of demands made of the State and, concomitantly, a general willingness to concede to the State a higher claim to production potential, i. e. a larger slice of the gross national product in real terms. A much more controversial matter than these basic issues is the question as to whether the additional share of the G.N.P. should be financed by taxes or by loans and, if the former, what taxes this should involve. A higher share of G.N.P. accounted for by governmental expenditure is usually funded by taxation. Yet even in the event of complete or partial financing on credit, the tax burden for the population seems certain to rise in the long run.
- Secondly, a unanimous call for improving the make-up of the national product, even though it is still not quite clear what form this should take.
- Thirdly, there is nevertheless a willingness to spend more on certain types of expenditure than was formerly the case. Examples of this are environmental protection and, today, education and research. What impact such ambitions (if fulfilled) would exercise in practice remains a controversial question. But it is beyond doubt, for example, that environmental protection binds certain production factors and thus affords a specific performance (i. e. a relative or absolute improvement in the environment) which would benefit consumers and producers alike.
- Fourthly, there is general support today for greater efforts in the Government's procedural and regulative policies within the framework of competition and price policies as well as trade-cycle steering. Yet precisely in this field, scepticism is spreading. The Keynesian type of anti-cyclical policy has lost much of its glamour. On the other hand, radical answers like establishing a regulated trade-cycle policy hardly attract any supporters and, in truth, the suggested solutions tend to discourage would-be disciples. There exists a large body of evidence to indicate that the preference in many fields is less for theoretically consistent answers than for slightly contradictory, but ad hoc decisions. An experimental phase might well burden us with new forms of economic regimentation.
- Fifthly, there appears to exist a unanimous demand that income must be distributed more equitably. In many cases, hopes are still pinned on wage policies. The idea is that continuous and sometimes large nominal wage increases will serve to wrest a higher share of national wealth step by step from entrepreneurs and the recipients of property income.

However, the experts take a sceptical view of the prospects for such a policy of redistributing national wealth. If there really does exist any scope for redistributing assets, it must surely be very small – although this has nothing to do with the change in ratios of distribution resulting from the increased shortage in relative terms of the labour factor (in comparison with capital). The upshot of this is as follows. If a nominal wage policy must not enhance the inflationary upsurge, restraint should be exercised in favour of other forms of distributing national income. Great emphasis is laid on the policy of encouraging the formation of wealth by statutory savings schemes and this policy enjoys the support of nearly every group in society. However, neither the political parties nor the various social groupings have so far put forward any comprehensive asset-formation plan which appears politically feasible and free from any move towards excessive regulation.

- Sixthly, a general trend has emerged towards consolidating the social commitment inherent in property. This is intended on the one hand to furnish more social security and on the other (as in the case of urban rehabilitation) to meet the wish for greater harmonization than hitherto between private control and public interest. The current problems also include the question of co-determination which will incorporate the concept of mutual dependence and co-responsibility – in whatever form such co-determination may appear.

No matter what solutions emerge for the basic problems, they will clearly alter social and economic realities just as the search for these solutions reflects the shifts in social awareness. At the same time, many questions considered taboo for many years are now being actively discussed. A big role has been played by the critics of the existing system here in West Germany who are regarded by many as a threat to the existing set-up or as a kind of revolutionary ferment. It might well be a fatal mistake not to treat them seriously, since their theses and programmes are backed by militant cadres eager to translate strictures into revolutionary deeds. Moreover, it is often difficult to draw clear-cut lines of division between the social groups. Another point: ideas may prove as infectious as influenza.

In spite of all this, it hardly looks as if our social and economic order is going to experience any really radical changes. A much more probable scenario will be the turn of events referred to above. They represent the appropriate means of accelerating an on-going evolutionary process and steering it into directions likely to promote rather than to impair the present system. Nevertheless, nobody ought to rule out completely a movement in the opposite direction.

Whatever the outcome turns out to be, it will probably no longer be feasible solely within a national framework. Despite all the impediments, the economic integration of Europe has inspired forces which are pressing for political changes. These could assume various shapes. At the same time, it may be of significance that we all have our roots in a similar European cultural awareness and that the European nations observe a common scale of values and priorities. By the same token, however, there exist great differences. There is, for example, the great diversity in life-styles and the variety of social groupings. There are the differing assessments of the central goals – not only in the field of economic policy – and the many special features of political action. Today, we still cannot predict what consequences this will engender for the economy and (even less so) for our social and economic order. That entails processes which can no longer be determined by ourselves alone – processes which may harbour many hazards and risks, but which may prove capable of counteracting potential radical movements in this country.

How Jeopardized is the Social Market Economy?

Christian Watrin

1978

In Germany, the Social Market Economy has now stood the test of 30 years of practical application. In the light of European experience with economic systems in the course of this century, this is quite a long period. The lifetime of other countries' experiments with economic policy and the economic order in general has been much shorter by comparison.

We need only recall the rapid succession of economic reforms in those east bloc states willing to undertake the risk of even a modest degree of liberalization and expansion of individual freedom of decision – reforms which were soon curtailed for reasons of power politics in order to make way for the miseries of a regimented society. Let us also bear in mind the various so-called «great leaps forward» in Asiatic countries in their frantic efforts to force the pace of economic growth and catch up with «world levels». These were invariably leaps to failure.

Even in neighbouring European countries, experiments with the economic order have not proved to be very successful. France's planification, for example, is no longer a talking point. Some of the major economic and social problems have only been partially solved and above all the spread of affluence among all classes of the population has not made as much headway as desired.

As regards Great Britain, that country stands on the threshold of a new debate on the appropriate economic order now that incomes policy, even in the form of a social contract, has turned out to be a disappointment. The industrial strife failed to slacken under the pro-union Labour Government, too. In the meantime, the British people have learnt from official statistics that their real disposable income has declined as a result of inflation and government restrictions on wages. Yet even this discovery appears unable to help in overcoming the vicious circle of mutual harm which the two sides of the labour market inflict upon each other through militant attitudes. We shall have to wait and see whether the market-economy strategy presented by the Conservatives in an effort to lead the party away

from the economic errors of Heath and Barber will get an opportunity to translate itself into practice at all.

Compared with other countries, economic policy in West Germany has been less fickle: as a result, our social market economy has not been subjected to so much hot-cold treatment as elsewhere. This may well be due to the great success of free-market policies in the last few decades, which has rapidly diminished the appeal of the alternative social order offered by the socialists since the Second World War. The value of free-market policies lies primarily in the scope of freedom provided for each individual member of the community, not merely pro forma but as an integral part of his everyday life. One of the essential features of the social market economy is that it furnishes not only freedom of trade but also freedom of movement for people. The incredible range of goods and services available to West German consumers represents another aspect of our achievements. However, the affluence flowing from economic freedom is only the second aspect of successful market-economy policies. Their principal manifestation apart from the enhanced standard of living lies in the high level of the German social security which, despite its considerable shortcomings, enjoys world-wide fame.

Nevertheless, there is no overlooking the fact that the market economy is again a matter of controversy and that there are political forces not only in the radical camp which favour forms of order at variance with market-economy principles. We should therefore hasten to ask ourselves the reasons why our free market-economy is apparently in jeopardy. There are three sources of danger and these may be conveniently abbreviated as:

- «technical» shortcomings;
- impairment of the fundamental consensus; and
- a lack of opportunities for personally experiencing the functioning of the social market economy.

Technical Shortcomings

This is a convenient heading for classifying those complaints that the capacity of a free-market economy for resolving problems has become inadequate because of the scale of current problems. This situation may then lead some people to assume that at least the politically prudent among us should be looking around for a more efficient economic system.

It is an old established tradition among economists to initiate discussions about the failures of certain branches of the economy or of entire economic systems. These range from the Marxists' perpetual claim that every emergency or recession reflects an inherent crisis in the capitalist scheme to those more modern doctrines which see the market economy as a system only able to function if «enlightened» policymakers point the way forward to balanced growth. If we leave aside the fundamental issue and turn to present day problems, the real question amounts to the following. Will the prevailing unemployment and the as yet unresolved problem of inflation prove amenable to a solution under the market economy or will a new economic system have to replace it? And if so, which one?

Let us begin our discussion with a reference to the official government optimism which, until a short time ago, was relying on the hope that a vigorous rate of economic growth in 1977 would at least cut the number of unemployed to well below one million. This hope has given way to a more sceptical assessment in recent months. At the present time, there is hardly anyone who expects to see full employment and price stability being achieved during the next few years.

But we in turn are entitled to be somewhat sceptical about the rapidly turning tides of hope and disappointment. The reversals of opinion are due in no small measure to those contemporary forms of cyclical predictions which exercise a lasting influence on at least the

psychological side of business activities pursuant to mutual coordination and uniform alignment. It should therefore be recalled that neither under a market economy nor under a centrally planned economy can anyone claim to know what the economic situation will be like tomorrow.

Let me illustrate this with a simple example. A short time ago, a congress of professional economic forecasters, meeting in Munich, found itself quite unable to make any reliable predictions about the future. This outcome speaks volumes for the integrity of the experts concerned. But we must go one step farther. While the professional «forecasters» have to believe that their problem can be solved in principle, there is sound reason for doubting whether this task can in fact ever be mastered.

Such an assertion is risky, particularly when one recollects how often «evidence» used to be adduced in former times to show that flying was impossible. For that reason, strictures on expert forecasting ought not to rest on alleged natural and economic laws, but on the simple methodological consideration that nobody here this evening knows exactly what Germany's economic position really amounts to. In order to determine this, it would not suffice for everyone to look in his cashregister at a certain time of the day, determine his assets and liabilities and count the stocks of goods in hand – although precisely that does happen in large retail businesses and moreover with surprising speed thanks to automatic data processing. Before we arrive at an overall picture of the economy, all the various data have to be collected in economic statistics and this sometimes lasts weeks. In other words, even the most zealous forecasters are only in full possession of the economic facts two or three months later! And anyone who takes a closer look at the situation finds that people will discuss for years about when a recession or upturn actually started. The attempt on the basis of yesterday's figures to predict the economic situation months or years hence seems to be as promising as the attempt to predict in which harbour a certain ship will be at anchor in a month's time on the basis of our knowledge of its position at sea a month ago.

Those who are still not convinced by this simple reflection may care to call to mind the unpredictable nature of the future in the light of the forecasters' past failures. Let us take a recent example. Shortly before the onset of the crisis in the Autumn of 1974, the German Institute for Employment (Bundesanstalt für Arbeit) presented a report entitled «Thoughts on a forward-looking Policy for the Labour Market» which, in turn, drew on a paper entitled «Perspectives of Labour Market Policy» published by the Federal Ministry of Labour in April of the same year. At the heart of the discussions stood the question as to how West Germany's productive potential must be increased in the long run in order to close the «widening gap between domestic labour potential and the demand for personnel consequent upon growth». In brief, the recommendations set out in the prognosis were for a drastic increase in the number of foreign workers. This faulty prediction ought to make those people think who simply take the lists of available workpeople and – irrespective of wage rates and structures – extrapolate the unemployment figures into the future and then conclude that only a mandatory shortening of working hours is likely to overcome underemployment. Neither a compulsory curtailment of the number of working hours per week nor a government-decreed increase in annual holidays nor a prohibition of overtime nor a statutory lowering of the variable age-limit for retirement – whether with or without compensation in wages or salaries – represent satisfactory methods for achieving the goal of an adequate level of employment. Quite apart from that, the whole fundament on which the forecast about the alleged excess capacity has been based must be questioned. The estimates of labour requirements do not take into account a basic component of the market economy: the high degree of adaptability among private households and commercial undertakings when mutually adjusting to new situations via a system of flexible prices. And it is exactly this flexibility in the adaptation of economic plans which constitutes a major advantage of the market economy over centrally controlled systems: everyone enters the market with his assessments and individual predictions in order to satisfy his needs by a reciprocal, though

often anonymous adjustment to the plans and intentions of the other participants. In this way, the market economy's system of coordination gains a wide measure of flexibility and a capacity to respond to unexpected challenges such as the oil crisis without breaking down.

However, the more that government measures and official forecasts steer the expectations of the population in the same direction, the greater will be the inclination to restrict the efforts at adaptation and the greater the danger of parallel action and failure. Consideration should therefore be given under a sound economic policy to restricting official or semi-official prognoses to the status to which they are entitled and no more, i. e. estimates or conjectures upon which every man of action bases his strategies and tactics. But it is completely misleading to arouse the impression that cyclical forecasts represent more than, at best, uncertain surmises, even if they have received the blessing of government approval. In the economic process proper, men of action of varying importance exercise an influence on each other's decisions. They endeavour to arrive at rational decisions on the basis of their assessment of future trends. The outcome of these decisions may well differ from what those concerned either expect or deem to be desirable. At any rate, it has proved to be an illusion to believe that «concerted» expectations pursuant to government prompting and official extrapolations can pilot events to the extent of obtaining balanced growth plus full employment.

A wider measure of objectivity towards the official economic forecasts and the Government's target figures based upon them would pave the way for the requisite analysis of the difficulties now besetting our economic order. Unfortunately, the discussion of this question threatens at the present time to become entangled in a sterile dichotomy. On the one hand, there are those who blame the economic policy-makers and members of the Government for the continuing inflation and unemployment whilst, on the other hand, there stands a group of people disposed to view the market economy and capitalism as the root of all evil and to allege that the market economy is inherently doomed to generate crises and under-employment. The first line of argument is inconsistent with the market economy in the sense that it refuses to concede to those in positions of political responsibility (constrained by the need for action to build on uncertain foundations) the right to make mistakes. Furthermore, such arguments arouse the impression that productive process and cyclical movements can be directed by governmental decision-making – but only, of course if one adheres to the policy recommended by the official advisors. This overlooks the fact that the market economy stands on the underlying principle of trial and error, i. e. the assumption that, whilst mistakes are fundamentally not ruled out, they can be subsequently corrected. Incidentally, the history of trade cycle policy abounds with examples of misconceived government decisions which cannot clearly be classified as «political». An equally important role must be assigned to blunders in economic theory.

But even the opposite school of thought is by no means more convincing. It arouses the impression that the social market economy is an organism with a will and viability of its own, an entity to which the guilt for undesirable conditions may be ascribed in much the same way as one blames human beings. However, a market economy is a complex and sophisticated set of rules with whose help people try to regulate their mutual economic and social relations on the basis of individual freedom. But it is misleading and intrinsically fallacious to make a free and democratic system responsible for all evil or to indulge in anthropomorphization, although this clearly does not exclude attempts at improving our market economy by adapting it to a certain scale of values. The firm shaping of a system founded on autonomous decision making and entrepreneurial self-responsibility, together with the freedom for consumers, savers, employees and the proprietors of production factors clearly is a question of economic order. An outcome of the debates of the Forties and Fifties on a free market order is the idea that one of the permanent functions incumbent upon the government consists in permitting and safeguarding free competition.

The foremost problem in current cyclical policy is the question of what to do in order to

regain the dynamism of market-economy processes. In this context, measures to improve the economic order probably enjoy greater priority than interventions into the economic process. One important starting point as regards the economic order is to correct the numerous measures which infringe true market-economy principles. At the present time, these measures weigh heavily upon individual decision-making and upon the flexibility of markets to adapt to changes. This issue is often discussed in connection with the debate on the spread of bureaucratization. In another context, it also relates to the question of the governability of a democratic State and the paralysis of the Welfare State faced by a spate of unrealizable claims and expectations which, due to special political circumstances, militate against the interests of the population as a whole.

In those cases, for instance, where the right of protection against dismissal and the obligation to pay high sums of compensation render it extremely difficult for enterprises to achieve the central aim of their social policy, i. e. to adapt to changing economic situations, the consequence of this will be not only a diminution of individual mobility (with attendant problems for the economy as a whole) but also the splitting of the labour market into a primary and a secondary sector. Whereas the threat to jobs in the first one remains small due to the limited opportunities for dismissal, the secondary sector virtually becomes a labour-market cushion. There gradually spreads through the whole economy a distortion of the pattern of employment. It is not the more capable and hard-working men and women who have a genuine opportunity of obtaining a job. Instead, the distribution of workplaces rests more and more on the fortuitous privilege of those already holding a position, the *beati possidentes*.

The position is similar in other sectors of direct market intervention such as housing, where the legislation on comparative rents protects the fortunate proprietors of dwellings but at the same time substantially curbs the notable economic function fulfilled by private investors in this market. The long-term results of such a policy are obvious: an inadequate flow of the volume of investment (now highly desirable for cyclical reasons); the restricting of regional mobility; the prevalence of bureaucratic distribution procedures; and the growing burden on the public authorities.

A reduction in the scale of interventions – which are contrary to the spirit of the market economy – and the replacement of protective measures likely to disturb the market by indirect transfer payments to socially disadvantaged persons naturally constitute a small part only of a stabilizing programme aiming at improving the economic order and at recapturing the dynamic vigour of the market economy. Such a programme would also include the development of rules for wages policy so as to emphasize the responsibility of both sides of the labour market for maintaining full employment.

The critical year 1974 saw the granting of wage increases which were no longer compatible with full employment in the light of the changes in monetary policy and the structural shifts in the export markets caused by the floating of the foreign exchange rates. The unexpectedly large increases in real wages (which were never fully offset in subsequent years) plus the difficulties in selling products resulted in unemployment and this has persisted until the present day. As long as we do not succeed in keeping wage increases in line with the rates of periodical productivity increases and in view of the numerous claims which militate against the general interests of the population even below these rates, then the regaining of full employment will continue to be uncertain. Contrary to widespread belief, the problem is not the lack of worthwhile jobs in German trade and industry. There is plenty of work available, though not at the ruling wage rates.

In addition to a stabilizing policy inspired by the wish to ameliorate the economic order, fiscal and monetary policy naturally have also played a role in regaining the economic dynamism of former times. In recent years, progress has been made towards monetary stabilization, even though public investments have had a procyclical impact.

One matter of controversy at the present time is the extent to which an expansion of public

expenditure would help to achieve a satisfactory level of employment and at the same time to avoid a fresh bout of inflation. The Keynesian argument deployed by the proponents of demand expansion that the productive capacity of the country remains under-utilized is somewhat dubious, since even the foundations of a statistical determination of the overall economic production potential are in themselves inadequate.

If it is politically possible to implement a stabilizing programme based on market-economy principles, the market economy is out of danger as regards the ups and downs of economic activity. If the measures adopted to recover economic dynamism prove to be successful, then many of the pessimistic warnings which now spread alarm about the employment level will soon fall into oblivion. The West German example of the Fifties and Sixties shows that unemployment figures far in excess of the number of people out of work today can be overcome by dint of a free-market economy whose potential for growth is stimulated by skilful policies. At the time, West Germany succeeded without much fuss in integrating twelve million expellees and over three million refugees from East Germany into the economic process. In addition, jobs were found here for two and a half million foreign workers during the period from 1960 to 1974.

Impairment of the Basic Consensus

Nevertheless, the threat to a free-market economy does not stem solely from the opportunities for coping with cyclical problems. Equal importance attaches to the question as to whether it rests on wide acceptance as a system.

The social market economy represents one component of a free order. But a liberal democracy and a social market economy as forms of social existence can only survive if a fundamental consensus exists among the overwhelming majority of the population that the rules of the system are sensible and worth defending. The fact that such a wide measure of agreement has been secured in West Germany cannot be asserted without qualification. The principles of an economic system largely premised on free enterprise sometimes evoke considerable controversy in public discussions. Other models for shaping the economic order such as «economic democratization» and the Yugoslavian type of socialist economy, supposedly based on workers' self administration, command high esteem in wide circles. Moreover, the introduction of co-determination for employees and trade unionists in the supervisory boards of large German firms represents an institutional measure whose overall economic impact still remains unknown. But the stumbling-block in a market economy is usually the origin of profits. In this context, little differentiation is made between monopoly gains which stem from restrictions on competition or efficiency gains which are the remuneration for finding new markets, new production processes or new goods, i. e. recompense for taking business risks or making discoveries.

Efficiency gains fulfil the important macroeconomic function of encouraging economic progress. However, their adoption by society takes place via imitation in the competitive process. But the fundamental prerequisite for ensuring that the universally competitive processes can effectively operate is private ownership of the means of production, which links the chances of gains and the risks of losses and leaves successes and failures to the entrepreneurs themselves. This marks the main difference between a market economy and systems involving common property of the means of production. In practice, these other systems have proved to be incapable of simultaneously inducing processes of creative change in a number of different sectors. That also applies to the so-called «socialist market economy» for which the entry by firms into new market raises problems whose solution involves violating the basic rules of the system. On socialist systems of common property it is true to say that they largely socialize the consequences of their misguided actions. In cases where the latter might lead to the punishment of individuals, there frequently exists no

reliable possibility for tracing wrong decisions by due process. The problem of socializing misconceived projects is also gaining in significance in the market-economy system at the present time. However, the criticism of the social market economy is also founded in those cases where governmental measures in the private sector infringe the principle that private losses have to be borne by private business itself. Subsidies, restraints on foreign trade and competition or minimum prices and market regulations can be decreed by the Government, who may also decide to introduce selective promotion of research or regional and infrastructural measures. As far as the economic order is concerned, this poses a problem of prime importance and there is no denying the danger that intervention-prone Governments may intentionally or unintentionally distort the spread of risks in a market economy by excessive official measures.

The practice of expanding the scale of governmental responsibilities in trade and industry – a process encouraged by the rivalry between the political parties – together with the inflation mentality deriving from the public supply of goods and services combine to generate the much-analyzed overstrain on the modern Welfare State. Under the pressure of a scarcity of financial resources, there is a great temptation to resort to pseudo solutions and to master the plethora of problems by infringing the constituent principles of a free market economy. The labour, farming and housing markets abound with examples of anti-market interventions, which in turn induces countermeasures among those affected and elicits renewed pressure upon the legislators and the Welfare State. Numerous solutions are attempted. Although some of these may be intelligible from the standpoint of those directly affected, they often evoke considerably less understanding from others accustomed to orderly administration and fairness of treatment. It is, for example, taken for granted by firms when threatened redundancies assume a political character that they can approach the Government with a view to compensation for enforced continued employment. Both cases constitute an infringement of the principles of free competition. A general agreement on the desirability of operating a free market economy depends on whether its basic rules are universally applied and respected. Even the spread of the belief that this is perhaps not the case jeopardizes the political will to submit to the rules of the market economy.

The opinions which we entertain about the world around us do not necessarily depend on de facto realities. Something which we imagine to be right often only has a vague relationship with reality. This observation is of particular significance for a complex system like the social market economy, whose various levels cannot be fully assessed either by a theorist or man of affairs, an individual or a team; there is a lot of room for ideological interpretation and those interpretations of the functioning of a market economy which are brought to the attention of the public significantly influence the forming of opinion.

In the interplay between the many opinions and theories forming one of the fundamental characteristics of a free society, the role of exploring the reality of a complex system devolves upon both the theorists and the practitioners of economic policy as well as upon the large numbers of opinion-shapers classified by the general public under the heading of «intellectuals». However, this is not the place to discuss the sociology of the intellectuals, a subject on which *J. A. Schumpeter* – thereby standing *Marx's* theory on its head – has furnished an interesting contribution in his theory that the decay of the «protective layers» will lead to the final erosion of the market economy. It would, instead, seem more appropriate to pursue the conventional economic standpoint and to turn our attention to the market and to the rivalry of ideas. The need for ideas to compete against each other derives from the imperfection and the continuous improbability of human knowledge. The additional interpretation of competition between ideas as a market stems from the circumstance that ideas are transmitted by the spoken or written word via media such as books, newspapers, radio, television, lessons and lectures and that there exists a demand for them among their public. We know just as little about the process of accepting or rejecting an idea as we do about the same process in goods and services. This does not preclude the possibility that the rules governing competi-

tion among ideas possess the greatest interest for those who consider the maintenance and development of a free system to be a desirable aim.

The view that the suppliers in the market of ideas are primarily interested in the preservation of a maximum degree of competition so as not to jeopardize the chances of their products is unfortunately not true. The same applies to the assumption about the attitude of competitors on the traditional markets for goods and services. A close investigation soon shows that the fight for restrictions on the market of opinions can be observed just the same as elsewhere, that official protection of non-governmental monopolies of opinion plays just as important a role as the defence of media privileges in the public sector and that the struggles to attain a monopoly in the purveyance of ideas are fought with a degree of bitterness virtually unknown on other markets. Let me illustrate that with a number of examples. The most important mass media of our times, broadcasting and television, have been endowed with constitutions which make them fairly independent of the Government whilst obliging them to present well-balanced programmes. As experience today has shown, however, neither the hazards of public relations in journalism nor the lapse of information into agitation nor the tutelage of consumers nor the ubiquitous spread of party politics have been exorcized. At the same time, the weak position held by consumers in the market for goods and services is mirrored in the P. R. market, too. Although consumers are still reminded of their role as «financiers» by virtue of the system of charging fairly expensive fees, they nevertheless enjoy few opportunities of voicing their preferences. A switch to competitive products is, for example, only possible in the case of television in those areas close to frontiers. Equally, consumers have no opportunity for paying the due fees direct to their favourite television station. In other respects, only such forms of protest are permissible as entail practically no danger for those responsible for the programmes. Letters and telephone calls from viewers provide a modest channel for working off one's anger. Consumer-type organizations also play a relatively unimportant and marginal role, whilst the supervisory boards manned by party politicians and prominent members of society often prove to be scarcely capable of combating manifest abuses. Although the news-purveyors often invoke the transition from the information system to the communications system, this has so far confined itself to an amateurish offer to studio audiences to take part or to phone in their opinions about programmes, which are then transmitted to the general public after careful filtering. The transition to a free broadcasting and televising system (no longer problematic because of any serious technical difficulties) in which entrepreneurial initiatives can develop has still a long way to go to judge by the position papers drawn up by the political parties on the media. Moreover, it runs the risk of being stifled by the well established policy of conducting a large number of pilot studies and by having claims lodged by the public-law corporations to the right of controlling private activities. The information facilities available, for example, to the British by virtue of the competition between state-owned and private radio and television are not exploited in this country. But it is an undeniable fact that only market competition gives consumers the chance of expressing their preferences. Communications between suppliers and consumers may well play just as subsidiary a role as a direct dialogue between reader and author, unless the latter happens to be desirous of literary fame and good sales and considers his person to be more important than his works.

The constitutional right of parents to enjoy a wide range of options in education from which to choose for their children whatever best accords with their aims is subject to similar restrictions as those on radio and television. Privately-run schools are comparatively rare and the establishment of new schools is beset by a number of administrative obstacles. The official regulations declare that any private school applying for state recognition must accept down to the last detail the curricula and organization of the state schools. No genuine competition can flourish in such conditions, even though it would clearly be possible and useful in the educational field. Hence, there are no opportunities for experiments with new

types of school and the only possibility of voicing one's views is the ineffectual one of lodging a protest. A simple example will suffice to make this plain. The demand side on the educational market is prohibited from participating in the choice of text-books, and there is no dignified way in which teachers may be rejected as unsuitable for the education of children. But there exist just as few technical reasons as for radio and television why one should adhere to state-run schools incorporated under public law. Economists have developed an idea for liberalizing education whereby parents and later the pupils themselves (when of age) would take vouchers to the school of their choice. However, the funding of a school's expenditure on staff and equipment would be made dependent on its comparative success or failure in the competition to attract pupils. Needless to say, such a highly competitive system cannot be organized unless you have a strong and well administered State controlling adherence to efficiency standards. But there is no need for that same State to operate all of the school system. A restriction of the State's responsibilities to supervising observance of the efficiency standards would generate an opportunity for taking much more systematic action against the organizational slack and muddle now beginning to spread through the school system and also to curb by means of competition the inefficiency springing up everywhere.

Lack of Opportunities for Personally Experiencing the Functioning of a Social Market Economy

The third potential danger to a free-market economy consists in the lack of opportunities for getting to know this system together with its operative rules at first hand. Recent political trends seem to indicate that opportunities are being curtailed more and more for experiencing a social market economy in action together with its chances and risks and to be able to judge it on the basis of personal knowledge. Admittedly, there is a large sector for a free choice of goods and services and of travelling, which possesses considerable importance in practice and which remains virtually unaffected by political measures. On the other hand, substantial efforts are now being made to diminish the areas of freedom and to subjugate them to government directives.

For example, the changeover to self-employment represents a genuine alternative to non-independent activities for a small percentage only of young persons. This trend may be seen from the high percentage of university graduates taking up official positions or similar appointments (an estimated 70% of all graduates) and also from the sharp fall in the number of self-employed. Similar phenomena are noticeable in the political and social sector:

- The foundations run by the large political parties are only partly funded from members' fees. They receive by far their largest sums from public budgetary sources.
- Youth organizations in which spontaneity and creativity ought to play a particularly prominent role are forfeiting their dynamism as a result of state subsidization on a substantial scale. Both their members and the managers of foundations thus forgo the significant personal experience that it can cause a great deal of trouble to convince others of the value of one's chosen objectives and to persuade them to effect voluntary payments for activities from which they do not derive any direct benefit.
- Charitable organizations in general and nonprofit hospitals in particular now find themselves exposed to the risk of being brought under the sway of state rule because of governmental standards for services on the one hand and state subsidies on the other.
- In all those areas where governmental interference with prices or the introduction of zero rates result in excess demand, there arises a need for regimentation and administrative allocation systems, thus making consumers a target for state regulations. The rationing of places at universities in the shape of a «*numerus clausus*» provides a particularly striking example.

- This trend has advanced farthest of all in the welfare sphere. Under national health systems, for instance, the available benefits are not primarily accorded pursuant to the wishes which the patients voice in the interest of their health, but pursuant to decisions taken by local bureaucrats stipulating the financial framework and subject to the doctor's discretion. Similar trends are taking place in the field of old-age insurance, even though they are not so clearly discernible at first sight. This begins with the instability of the «solidarity pact» between the generations as reflected in the restricted possibilities of determining in advance what sum will be paid out in old age – a sum, moreover, liable to change by legislative measures.

Wherever bureaucratic allocation mechanisms start to replace markets, this affects the empirical knowledge of those concerned. It is no longer a sense of self-responsibility and the risks and chances of the market which determine the opportunities for development and action: the alternative nowadays is a skilful adjustment to bureaucratic «constraints». In certain cases, individual inventiveness may result in surprisingly good results in the relationship between what one pays into the system and what benefits one derives from it. But this display of uninhibited egoism in the successful assertion of one's own claims vis-à-vis social welfare systems is not exactly the private virtue on which the social order wishes to place its reliance in a society of free people. The popular criticism of highly egoistic behaviour as being socially harmful and exploiting collective organizations merely blinds us to the fact that bureaucratic allocation mechanisms reward precisely such patterns of behaviour, because they set aside the permanently valid market principle that better supplies can only be obtained in exchange for higher performances on one's own part.

Germany's free market economy is now in danger. The origin of this danger lies less in the current cyclical problems (which is where most people assume it to be located). Greater importance attaches to the jeopardy to the basic consensus and the power struggle in the quest to win men's minds in the media markets. The most disquieting situation prevails in the field of bureaucratic regulation, particularly in the social welfare sector. Here, the impenetrable jungle of governmental provisions has meant that the alternative of a rational solution of many problems via the markets – even though such a solution is not always an easy-going matter for those involved – is now liable to be completely overlooked in public discussions.

Part II

**The Theoretical Basis
of the Social Market Economy**

Chapter I

Production

Section I

The Functions of the Market

The Merits of a Free Economy

Adam Smith

1776

[. . .] Every individual, it is evident, can in his local situation judge much better than any statesman or lawgiver can do for him. The statesman who should attempt to direct private people in what manner they ought to employ their capitals would not only load himself with a most unnecessary attention, but assume an authority which could safely be trusted, not only to no single person, but to no council or senate whatever, and which would nowhere be so dangerous as in the hands of a man who had folly and presumption enough to fancy himself fit to exercise it.

To give the monopoly of the home-market to the produce of domestic industry, in any particular art or manufacture, is in some measure to direct private people in what manner they ought to employ their capitals, and must, in almost all cases, be either a useless or a hurtful regulation. If the produce of domestic can be brought there as cheap as that of foreign industry, the regulation is evidently useless. If it cannot, it must generally be hurtful. It is the maxim of every prudent master of a family never to attempt to make his own shoes, but to buy them from the shoemaker. The shoemaker does not attempt to make his own clothes, but employs a tailor. The farmer attempts to make neither the one nor the other, but employs those different artificers. All of them find it for their interest to employ their whole industry in a way in which they have some advantage over their neighbours, and to purchase with a part of its produce, or what is the same thing, with the price of a part of it, whatever elsethey have occasion for.

What is prudence in the conduct of every private family can scarce be folly in that of a great kingdom. If a foreign country can supply us with a commodity cheaper than we ourselves can make it, better buy it of them with some part of the produce of our own industry, employed in a way in which we have some advantage. The general industry of the country, being always in proportion to the capital which employs it, will not thereby be diminished, no more than that of the above-mentioned artificers; but only left to find out the way in which it can be employed with the greatest advantage. It is certainly not employed to the

greatest advantage when it is thus directed towards an object which it can buy cheaper than it can make. The value of its annual produce is certainly more or less diminished when it is thus turned away from producing commodities evidently of more value than the commodity which it is directed to produce. According to the supposition, that commodity could be purchased from foreign countries cheaper than it can be made at home. It could, therefore, have been purchased with a part only of the commodities or, what is the same thing, with a part only of the price of the commodities, which the industry employed by an equal capital would have produced at home, had it been left to follow its natural course. The industry of the country, therefore, is thus turned away from a more to a less advantageous employment, and the exchangeable value of its annual produce, instead of being increased, according to the intention of the lawgiver, must necessarily be diminished by every such regulation.

By means of such regulations, indeed, a particular manufacture may sometimes be acquired sooner than it could have been otherwise, and after a certain time may be made at home as cheap as or cheaper than in the foreign country. But though the industry of society may be thus carried with advantage into a particular channel sooner than it could have been otherwise, it will by no means follow that the sum total, either of its industry or of its revenue, can ever be augmented by any such regulation. The industry of society can augment only in proportion as its capital augments, and its capital can augment only in proportion to what can be gradually saved out of its revenue. But the immediate effect of every such regulation is to diminish its revenue, and what diminishes its revenue is certainly not very likely to augment its capital faster than it would have augmented of its own accord, had both capital and industry been left to find out their natural employments.

Though for want of such regulations society should never acquire the proposed manufacture, it would not, upon that account, necessarily be the poorer in any one period of its duration. In every period of its duration, its whole capital and industry might still have been employed, though upon different objects, in the manner that was most advantageous at the time. In every period, its revenue might have been the greatest which its capital could afford, and both capital and revenue might have been augmented with the greatest possible rapidity.

The natural advantages which one country has over another in producing particular commodities are sometimes so great that it is acknowledged by all the world to be in vain to struggle with them. By means of glasses, hotbeds, and hotwalls, very good grapes can be raised in Scotland, and very good wine too can be made of them at about thirty times the expense for which at least equally good wine can be brought from foreign countries. Would it be a reasonable law to prohibit the importation of all foreign wines, merely to encourage the making of claret and burgundy in Scotland? But if there would be a manifest absurdity in turning towards any employment thirty times more of the capital and industry of the country than would be necessary to purchase from foreign countries an equal quantity of the commodities wanted, there must be an absurdity, though not altogether so glaring, yet exactly of the same kind, in turning towards any such employment a thirtieth, or even a three hundredth part more of either. Whether the advantages which one country has over another, be natural or acquired, is in this respect of no consequence. As long as the one country has those advantages and the other wants them, it will always be more advantageous for the latter rather to buy of the former than to make. It is an acquired advantage only which one artificer has over his neighbour who exercises another trade; and yet they both find it more advantageous to buy of one another than to make what does not belong to their particular trades.

[. . .] Those systems, therefore, which preferring agriculture to all other employments, in order to promote it, impose restraints upon manufactures and foreign trade, act contrary to the very end which they propose, and indirectly discourage that very species of industry which they mean to promote. They are so far, perhaps, more inconsistent than even the mercantile system. That system, by encouraging manufactures and foreign trade more than agriculture, turns a certain portion of the capital of the society from supporting a more

advantageous, to support a less advantageous species of industry. But still it really and in the end encourages that species of industry which it means to promote. Those agricultural systems, on the contrary, really and in the end discourage their own favourite species of industry.

It is thus that every system which endeavours, either, by extraordinary encouragements, to draw towards a particular species of industry a greater share of the capital of the society than what would naturally go to it; or, by extraordinary restraints, to force from a particular species of industry some share of the capital which would otherwise be employed in it is in reality subversive of the great purpose which it means to promote. It retards, instead of accelerating, the progress of the society towards real wealth and greatness; and diminishes, instead of increasing, the real value of the annual produce of its land and labour.

All systems either of preference or of restraint, therefore, being thus completely taken away, the obvious and simple system of natural liberty establishes itself of its own accord. Every man, as long as he does not violate the laws of justice, is left perfectly free to pursue his own interest his own way, and to bring both his industry and capital into competition with those of any other man or order of men. The sovereign is completely discharged from a duty, in the attempting to perform which he must always be exposed to innumerable delusions, and for the proper performance of which no human wisdom or knowledge could ever be sufficient; the duty of superintending the industry of private people, and of directing it towards the employments most suitable to the interest of the society. According to the system of natural liberty, the sovereign has only three duties to attend to; three duties of great importance, indeed, but plain and intelligible to common understandings:

1. the duty of protecting the society from the violence and invasion of other independent societies;

2. the duty of protecting as far as possible, every member of the society from the injustice or oppression of every other member of it, or the duty of establishing an exact administration of justice; and

3. the duty of erecting and maintaining certain public works and certain public institutions, which it can never be for the interest of any individual, or small number of individuals, to erect and maintain; because the profit could never repay the expense to any individual, or small number of individuals, though it may frequently do much more than repay it to a great society.

The Non-State («Natural») Laws Inherent in a Competitive Economy

Franz Böhm

1933

The fundamental assumptions on which the teachings of the classical economists hung were that production served exclusively to fulfil consumption, that the consumer's interests represented the sole directly justifiable economic interests and that in particular the producer's interests could only be taken into account inasmuch they satisfied the needs of the consumer. In other words, the producer's interests rested on a *derived* economic justification: «consumption is the sole end and purpose of all production and the interest of the producer ought to be attended to only so far as it may be necessary for promoting that of the consumer».

This line of thought may well seem self-evident, since nobody will regard production as an end in itself. Nevertheless, the unswerving consistency with which the advocates of classical national economy have drawn the appropriate inferences from this proposition suggests that it should be placed to the fore of our discussions.

In almost all other spheres of independent work and productive activities, the producer enjoys a wide measure of autonomy and freedom of action. A producer expects the recipients of his wares to evince a certain minimum respect for the craft and technical skills of his occupation, his vocational experience and the personal qualities which he brings to bear on his work. The old adage that he is here because of this task and not vice versa has the following implication for the producer: he should bear in mind the aim of his activities without, however, permitting his clients to dictate to him in every phase how he should behave with due humility. His wish remains, above all, to be accountable to his professional ethos. He regards any inordinate subordination to the favour of his patrons as a shackle inhibiting the free and unrestricted development of his productive capacities.

This need for freedom of action in production has been taken into account in economic life in all those constitutional provisions designed to safeguard existing workshops and well-

functioning production units by assuring them of a market for their exclusive use. Monopolies and privileges of this kind were accorded either to important entrepreneurs such as mine-owners and wholesale merchants or to cooperative groups such as guilds and corporations.

Clearly, a producer-oriented industrial peace of this kind, which exposes the market and the purchasing power of the consumers to the tender mercies of the privileged entrepreneurs and their business associations, rests to a considerable extent on the conscientiousness, the sense of duty and the feeling of social responsibility among producers. The moral danger peculiar to these systems is that entrepreneurs are enabled to determine for themselves the size of their income and profit by means of price-setting or that they at least believe they enjoy this possibility. Where the price cannot be forced up any higher, they can still raise their income by economies of cost and labour i. e. by a deterioration in performance. The more significant a branch of trade becomes for satisfying the needs of the population, the greater the share of overall purchasing power which it can divert for itself by exploiting the monopoly situation. The attendant losses must then be borne by the consumers and those trades whose services command smaller demand, but which would have been used if the stronger monopolizer had not availed himself to the full of his purchasing power.

Admittedly, monopolies and privileges have traditionally only been granted subject to certain conditions – conditions intended to thwart the exploitation of a protected market. The substance and vindication of an economic system based on privilege and monopoly depend entirely on the effectiveness of the legal and ethical code in furnishing juridical and moral counterweights to offset undue profiteering. The system of organization adopted by a monopolistic economy must in no circumstances emulate the private profit motive of monopolistic entrepreneurs. That would result in blatant injustice and in a savage system of jungle law. Only two options may be taken into consideration as a suitable form of organization for such an economy: either the direction of the economy by the State or the social conscience and sense of social obligation on the part of the privileged entrepreneurs and groups, i. e. the self-administration and direction of the economy by social-minded trade associations.

In consequence, only such States possess the moral authority to set up an economic system of this kind as feel able to direct an economy divided up into various trades and professions with sufficient authority and commercial acumen or as have such political and social charisma that an attempt at asocial behaviour by privileged groups and persons is bound to fail in the face of public opinion and culture against a background of social, political and religious tradition.

As we know from economic history, all privileged systems – with one exception – have foundered on these rocks: the beneficiaries of privileges not only failed to meet the requirement about social conduct but also mostly succeeded in winning the interest of the State authorities in their asocial policy of exploitation and profiteering. As long as States have existed, Governments have found themselves in need of money and indeed faced by a shortage of money. The historic roots of the system of monopolies and privileges must be sought in the calamitous lack of financial resources rather than in the concept of a planned economy. The transactions which took place between the «royal merchants» and their tax-oriented kings were not always unobjectionable. In economic life, the private profit motive usually prevails as a phenomenon of elementary force as long as the independent merchant bears responsibility in trade and industry. Only the concurrence of unusual circumstances such as marked the heyday of medieval urban economies proved capable of overcoming the wish for profit as a dominating motive in economic behaviour. Only that was able to deprive it of its socially dangerous aspects (e. g. by means of the rigid local limits on trade, the convenient size of craftsmen's workshops, the simplicity of people's lives, the warmth of human relations and the familiarity of everyday life, the power of accepted customs in

production and consumption, the economic dependence of master craftsmen on their public reputation as free citizens, the compelling force of vocational codes of behaviour and standards, the prevailing piety and the steady, albeit energetic rhythm of respectable middle-class life in self-contained communities). By the same token, it is scarcely possible to instil vitality into a system of private monopolies by dint of organization and appropriate techniques such as the establishment of an administrative and supervisory government body or the appointment for monopolistic enterprises or associations of parliamentary committees, whose members also include workers and consumers' representatives. For, all these external institutions deemed by the entrepreneurs to be inimical to their interests will perhaps have the effect of frightening off private enterprise without releasing any new source of productive impetus. But whatever motive may govern commercial activities (i. e. assuming that such operations are left to the entrepreneurs themselves), it must at any rate be a positive motive. The choice lies between the profit motive and the common weal. However, an economy cannot be built up on a handicapped quest for income. That would bring about a situation in which the supervisory agencies distrusted the profit motive and hampered the attendant productive activities wherever possible, whilst the entrepreneurs endeavoured to dupe their supervisors – probably with considerable success.

At the time when the physiocrats and *Adam Smith* were propounding their theories, the long-accepted ethical and legal barriers had long since forfeited their impact and ascendancy. In an era of inventions, discoveries and colonial acquisitions, however, the pursuit of profit had undergone a gigantic upsurge. It was the century of mercantilism – an economic period when scientific curiosity turned to economic matters and when theoretical doctrines started to influence practical commerce. It was also a period when the greed for gain invariably accompanied the exploitation of government privileges and when national economies fell under the «influence of shopkeepers» and the insidious arts of small-scale merchants made their appearance among the administrative procedures of a great Empire.

One of the then current ideas, keenly espoused by the Scottish School, consisted in the attempt to make an honest subject of the private pursuit of profit and to recognize in law the role which the profit motive was in fact playing in practice. At the same time, there had to be an end to the protected freedom of action accorded to producers. The quest for profit ought not to operate to the detriment of a helpless consumer tied to the apron-strings of the producers. On the contrary, the consumers should be liberated and enabled to choose from among the suppliers the one who met their requirements most thoroughly and willingly. This link between the profit motive and competition placed the entrepreneur's pursuit of profit in the direct service of the consumer. Only those with something to offer the consumers could realize a gain and this in turn became an automatic, precise and sensitive criterion for assessing a producer's economic qualities. It evolved as an unerring yardstick for judging the scale of his success in meeting his commercial goals and the extent to which the economy as a whole really required his services. Under the impact of this system, anyone desirous of undertaking a business activity had to adjust his profit instinct to his optimal function in the national economy, since that invariably represented his optimal opportunity under the private-enterprise system. Equally, dwindling profits and certainly losses showed the entrepreneur that his particular place in the economy was no longer required and induced him to turn to more worthwhile operations, i. e. those of greater economic benefit.

The elimination of a protected freedom of action also terminated the very right of economic existence. Anyone equipped with the requisite skills and funds was to be given the chance to establish a livelihood and the success of this would depend on his ability to generate a profit. On the other hand, even the most skilful and experienced of producers would find himself being squeezed out of the economic process as soon as his business failed to make a profit. The legality of the profit motive was attained at the expense of a loss in legitimacy for commercial undertakings. Contrary to the composure with which this

sentiment is voiced today, one could not in that age expect to enjoy the right of opportunity to realize a commercial gain whilst at the same time rejecting the risk of making a loss. One could not in the same breath lay claim to freedom to make a profit and simultaneously insist on the right to have competitors thrust aside. After all, competition forms the moral backbone of a free profit-based economy whereas the organizational principles underlying an economy with restricted competition are inspired by the common weal – but never by the pursuit of commercial gain.

The system of free enterprise and a free exchange economy would probably have not been criticized so much if the huge release of energy occasioned by its introduction had brought about a steady upturn and an even pace in economic advancement. In this case, presumably only those enterprises clearly lacking the requisite standards of excellence would have been eliminated – an acceptable hardship in the circumstances. In point of fact, however, there has been a powerful ebb and flow of economic fortunes under such a system. During the upward phase, the growing ratio of earnings to capital exerts a dazzling power of attraction for the entrepreneur in pursuit of profit and the outcome of this is a tremendous rate of expansion. The period at the end of the upward phase and the beginning of the decline is marked by overproduction. This overexpansion makes it necessary to consolidate the production and distribution facilities: a relatively large number of firms, including many reputable and established names, become superfluous and collapse, whilst new concerns which advanced during the upswing try to maintain their position.

The second movement which interrupts the continuous advance emanates from technical or organizational inventions and improvements and from rationalization of the economy in the broadest sense of the term. Let us imagine at a certain point of time that the condition of the economy, the cultural level achieved by society and the purchasing power of consumers result in the creation and satisfaction of a certain demand. Then comes a series of inventions which render it possible to satisfy the same demand at cheaper prices. This not only releases purchasing power among consumers, but also engenders wide-ranging changes in the occupational make-up of the whole economy due to revolutionary technical and organizational changes in production methods. Everything alters: the workers' activities and even the number of workers engaged in the factory; the organization of production and work, the distribution of income, the size of firms and their legal form; the relationship and distance between producers and those working in their factories; and indeed the whole communal existence of the population including their family life. The inventions bring about a transformation in culture. Hand in hand with this goes a shift in the demand which originally ushered in this whole welter of social change so that the population perhaps now turns away from the very goods which engineers and organizers have striven with skill and acumen to supply. It is a causal nexus which, in oversimplified terms, means that people find themselves forced because of their needs as consumers and their wish to be able to enjoy their leisure hours to accept continuous changes in production and work, to reorganize and subdivide their time and to engage in some kind of specialization. This takes place until they finally prove unable to understand the whole point of their share of the work. They spend those hours of the day in which they develop their optimal energy in the pursuit of activities unrelated to their domestic and real existence, which can no longer fully satisfy their capabilities or their mental capacity and their imagination. But since the cultural advance of a nation primarily hinges on its advances in production, the uncertainty of working life plus the headlong pace of productive improvements and the emptiness and impersonality of factory life exercise an impact on the whole fabric of culture. This in turn generates in the field of consumption a restlessness and uncertainty of judgment, and a haphazard pursuit of a make-believe world and of happiness dispelled from the productive sphere. Amongst those who benefit from this turmoil are the practitioners of the hypnotic advertising arts. They set up huge industries and innumerable auxiliary trades on the basis of a susceptible, unsure and aimless consumer world. But they all stand on uncertain ground: the incessant spate of

technical and organizational advances constitutes a real threat and undermines the fundamental features of their existence.

If one leaves aside a cultural and social assessment of these manifestations and merely contemplates the technical suitability of a country's economy to which changes of such moment and such celerity adjust, it becomes clear how much turns upon the smooth elimination of superfluous enterprises. On this ability of trade and industry to carry through a rigorous and spontaneous process of consolidation depends the avoidance of a catastrophe caused by the ebb and flow of cyclical movements and the shifts in mass demand. Only such industrial consolidation is able to withstand an economic decline. However paradoxical it may sound, the elasticity of the economy in this respect is the only way to stabilize life. The more rigid the structure of an economy proves to be and the more obstinately superfluous enterprises cling to their economic existence, the more violent will become the swings of the cyclical pendulum and the economic consequences of social change. The mainstream of pulsating life cannot be turned aside by erecting dams, however stable their construction. One cannot construct cities on trembling ground; and the way to master movement is to keep moving oneself.

The instrument which trade and industry must employ in order to cushion such violent changes is a timely and adequate cut in prices. Such substantial and psychologically difficult change represents a step about which an economy or a branch of the economy challenged by this commercial necessity can virtually never make up its mind in time. That stands clearly revealed in the present crisis among those sectors which are dominated by cartels. In particular, a system such as a quota-fixing or marketing cartel (which reacts to falling demand with a general and uniform reduction in the number of employees) will find itself unable to work more cheaply during a cyclical downturn. On the contrary, it is bound to become dearer because a fall in the level of employment will raise the cost of each item produced or traded. An economy organized pursuant to the quota system must therefore offer its goods during critical periods at loss-making prices in order to offset the drop in demand through such a cut in prices and then try to recoup these losses by means of substantial profits during boom conditions. In other words, the setting of prices in such an economy would have to be the exact opposite of the movement in costs – a pattern of behaviour which modern cartels only espouse under extreme pressure and then invariably too late. As they take a pride in keeping prices stable and in not following the upward movement in prices in a favourable economic climate – a completely erroneous principle – these cartels find themselves in the same position as the foolish virgins in the parable i. e. without stores in times of need. They prove unable to accept the sacrifice of a rigorous cut in prices and indulge instead in lamentations about high costs.

Under a freely competitive system, however, a reduction in prices is possible because the place of the marginal type of enterprise on the borderline between profit and loss (which determines prices) is taken by the better, more rational firm as a result of the elimination of superfluous enterprises until the cyclical downswing comes to a halt. If the economic process of a competitive economy were to operate strictly in conformity with performance or efficiency, no-one at all would appear on the market even during the most profound crisis unless he could at least recoup his prime costs. At that moment when he no longer found this possible, the entrepreneur in question would then pass on the position of marginal enterprise to a firm which was just managing to survive at lower prices. The number of concerns remaining in trade and industry would correspond to the number actually required: they would be the superior ones and they could face up to the crisis with a full staff or at least a relatively high level of employment.

As we have seen, the process of industrial consolidation never takes place very smoothly and precisely, even under conditions of completely free competition: those producers who can maintain their position do so. At any rate – and this remains the important thing – the movement in prices follows the decline in business activity with greater rapidity than

normally prevails in an economy whose anticyclical policy is subsidized by large banks and by the State and in which many of the major economic sectors are dominated by monopolies or cartels and, even in the free sphere, by gigantic concerns and combines.

Although the sequence of operations in a free exchange economy is distorted by all sorts of disturbances which classical teachings often overlook, such a system nevertheless possesses the highest degree of elasticity. It enjoys the capacity of adapting production to the vicissitudes of changing needs, stimulating the productive skills of the entrepreneurs and deploying them at those points of economy where they are needed. Such a system offers the individual producer a fairly reliable compass with which to plot his opportunities for making a profit. That renders it psychologically easier for him to align his attitudes with the requirements of the economy as a whole and it also promotes fairly equitable career structures.

The traditional school of economic thought took a more perfectionist view of all this friction and resistance and did not reckon with the incidence of animosity against the system. It was the optimistic paternal philosophy of an age impressed by the efflorescence of technical sciences – an age which accepted *Newton's* concept of the world in the complete appropriateness of its creations as a perfect machine fashioned by the divine master. It was an age which assumed that every human impulse had a predetermined significance in the Creator's overall design. All thinkers of that epoch studied the phenomenon of human egotism and examined the role which fell to this apparently asocial and «non-benevolent» impulse in the overall mechanism of the social fabric. *Smith* himself found much to censure among human selfishness in general and commercial self-seeking in particular. In his view, however, this impulse lost his anti-social aspects under the impact of competition and then joined together with the efficiency principle, the will to save and personal industriousness to form a virtue from which social and ethical recognition could not be withheld. His idea was that the impetus of competition could not fail to bring about a pre-stabilized harmony between personal gain and the public weal. After all, individual interests do not run counter to each other if they move within the boundaries drawn by God. Admittedly, they may become inimical to each other if the principles of natural justice are not observed, since the self-interest exceeding that boundary-line destroys natural harmony.

Thus, we see how an economy left to itself, liberated but nevertheless dominated by the strict rule of efficient competition, proceeds to develop a system of greater perfection than would be possible under systematic direction and regulation. The proponents of this theory reject all centrally planned economies as a cruder, more fallible, arrogant and artificial system. There was considerable antipathy in that epoch to the activities and posturings of statesmen and politicians. The philosophical antecedents of *Adam Smith* and the physiocrats, too, disdained economic organizers and «forgers of plans», since they preferred a natural scheme of things to some artificial political construction.

However, we can find nothing in this standpoint to justify such designations as a system of aimlessness, an atomistic exchange mechanism, a struggle by all against all or the principle of freedom of wild beasts. Although these currently prevalent ideas may stem from social disappointment with the system or the later monumental teachings of eminent economists and the more impressive emotional style and realistic force of social criticism, they nevertheless remain fallacious and instigate more confusion and mischief than that normally imputed to the «Manchester School». As long as one has neither an opportunity nor the strength to replace a free exchange economy without further ado by a centrally planned economy and as long as one does not dare to eliminate the struggle completely and to bring peace to the economy, then all those adverse viewpoints and misjudgments will merely conduce to free the pursuit of personal gain from its link with the efficiency principle, to invalidate the ethics of the system (albeit not the system as such) and thus foster the currently modish adulteration and corruption of a de facto still indispensable system and to strengthen the hand of those persons whose pursuit of wealth is no longer the spirit and driving force

behind a turbulent economic life but merely its parasitic beneficiary. It is uncanny and disquieting to observe how the ethically and socially more serious and significant intellectual movements of our times undertake every effort to demolish the morale of the contemporary economic system, to promote its corruption and to release the modern entrepreneur from the ethos of the Constitution to which he owes his livelihood and his freedom. What infatuation it is to concentrate one's moral indignation on the institution of competition whilst viewing with indulgence and benevolence the pursuit of material gain which, without this institution, represents a grave social hazard i. e. when it is organized along collectivist and cooperative lines, thus often acquiring that arrogant nuance peculiar to man when he acts as a member of a coterie.

A Policy for Establishing a System of Free Enterprise

Walter Eucken

1952

The Fundamental Principle

1. As we now know, the economic policy-makers of both the period of laissez-faire and the subsequent experimental epoch underestimated or failed to note the significance and difficulty of the problem of providing adequate direction for the economic process – a problem which entered into a new phase upon the commencement of industrialization. The principal omission was, and remains, a failure to appreciate the close link between all economic facts and the indivisibility of any smoothly functioning control mechanism. By virtue of their general interdependence, all economic measures exercise an impact on trade and industry. As has often been demonstrated, a deliberate downward adjustment of the rate of interest invariably brings about a change in the whole price system and thus in the whole steering of the economic process.

The vociferous economic discussion about the control of the economy conceals the fact that the real problem began to attract less and less attention as time passed by. True, types of marketing and monetary systems were permitted in the age of laissez-faire with a consequent formation of prices which only fulfilled an imperfect steering function. Yet at a later stage – during the period of economic experiments – the lack of proper concern became even more pronounced. The habit of thinking in terms of prices soon disappeared. Whether it was the policy of full employment which partly sterilized the price system, the policy of low interest rates and the rationing of foreign currency or whether central planning agencies attempted to steer the economic process (which was only possible pursuant to overall assessments) – the outcome was always an underestimation of the singularly difficult problem of giving direction to the wide-ranging field of trade and industry and their overall economic implications.

2. The time finally came for a change. The fundamental issue in modern economic policy has been recognized as a matter of fundamental interest. This takes place by making the inception of a viable system of unrestricted competition the essential criterion of every economic measure. That represents the fundamental principle underlying a modern economic system.

It cannot be right to adopt a trade cycle policy which hinders or terminates the viability of the price system under the impact of a temporary emergency. That happens, for example, with foreign exchange controls, credit expansion etc. By the same token, a tax policy must not set out to promote the process of industrial concentration by the turnover tax or the corporation tax and in this way also help the advance of monopolies. Both in this branch of economic policy and in others, the fundamental principle of the nation's «economic constitution» should operate for every single measure adopted. There are no exceptions to this axiom.

3. The fundamental principle not only calls for abstinence from certain economic acts such as government subsidies, the establishment of mandatory State monopolies, a general freeze on prices, prohibitions of imports etc. Nor is it enough simply to prohibit cartels, for instance. The principle is not primarily negative in nature. There is, rather, a need for a positive economic policy aimed at developing the marketing structure of unrestricted competition and thus at realizing the fundamental principle. This is also a field in which the competitive system differs entirely from the policy of *laissez-faire*, which in substance did not admit of any positive system of economic regulation.

Let me repeat this point. The main concern is to make the price mechanism workable. That is the strategic position from which one dominates the whole field and upon which all forces should be concentrated. Let us adhere to the significance of this key proposition: it is just as important for economic policy as it is for strategy.

The next step consists in developing each of the positive principles making up the system for regulating competition and jointly embodied in the fundamental principle described above.

The Primacy of Foreign Currency Policy – the «Currency Stabilizer»

1. Lenin once remarked that the way to destroy bourgeois society was to devastate its monetary system – an observation whose demagogic form concealed a great deal of truth.

In a centrally administered economy, money plays an insignificant role. What a family is able to purchase does not depend so much on its income in money form as on the rations allocated to it. Factories also receive their raw materials in line with the allocations decreed by central agencies and not pursuant to their monetary purchasing power. The decision about whether or not investments are carried out does not come from the producers and the banks providing the loans, but from central administrative bodies. Since prices do not govern the economic process under such systems, money is not essential for its regulation. Monetary policy does not occupy first place in such countries: it is assigned a very lowly place.

2. In this regard, too, free competition forms a contrast to a centrally planned system. The valid principle here is that all efforts to translate a system for regulating competition into reality are fruitless until a certain stability in the value of money has been ensured. For this reason, monetary policy is of prime consideration for the competitive system. A good illustration of this may be seen in German economic history since World War I.

During the postwar period, inflation emerged in manifest and accumulated form. The undisguised inflation of the years between 1914 and 1923 deprived the steering mechanism in the price system of its capacity to guide the economic process in adequate fashion. After all, prices tend to rise unevenly. For example, rents or the cost of certain raw materials remain

low, whilst other prices increase more rapidly. As a result, business cost accounting becomes inapposite because the price ratios no longer reflect the scarcity of goods. Yet even if all prices had risen in a constant proportion, there would nevertheless have resulted a distortion. Long-term business debts remain the same even where the prices of products and of the means of production continue to rise. The assets side of the balance sheet expands, whilst debts remain constant. That results in profits from inflation instead of from the skilful direction of the economic process. Moreover, such production activities as would have been restricted or abandoned under an accurate accounting system are retained.

However, a form of accumulated inflation such as Germany experienced between 1936 and 1948 – when prices were frozen while the money supply increased – immediately immobilizes the system. The time-lag in the basic underlying facts of the economy no longer manifests itself in the prices. As demand exceeds supply on the markets, rationing and central controls have to be introduced – at least for the important products such as coal, iron, leather etc. Hence, the price system rapidly forfeits its steering function. The uniformity of the housekeeping accounts comes to an end.

But a *deflation* such as occurred in Germany between 1929 and 1932 also distorts the price structure. Certain prices remain relatively rigid, whereas others fluctuate in rapid succession. Losses only appear because individual prices fall more sharply than others during the deflationary period. The assets side of the balance sheet shrinks, whilst the debts remain constant.

3. The precept of assigning monetary policy a special status in economic policy also serves a regulative purpose. Measures implemented in accordance with this principle «do not sacrifice the economy to the currency». The opposite holds true. A certain stabilization in the value of money permits the incorporation of an appropriate steering instrument within the economic process.

If we succeeded in stabilizing the currency situation via the value of money, then we could hope that the inherent trend in the system of free competition towards a healthy balance would make its influence felt instead of abruptly changing as in the past into a continuous up-and-down of inflation and deflation due to the faulty design of the existing monetary system.

However, a good monetary constitution should not only be designed so as to keep the value of money as stable as possible. It ought to fulfil a further condition. Like the system for regulating competition, it ought to function as automatically as possible. This is not only because the monetary set-up and the general economic system should be established in keeping with the same principle, but also above all because past experience has taught us that a monetary system which gives *carte blanche* to the makers of monetary policy believes them capable of achieving more than is actually the case. These persons are influenced to the detriment of their assigned task by their ignorance of all the relevant factors, their weakness vis-à-vis interest groups and public opinion, and their susceptibility to false theories. Particularly in the present situation, there exists a great danger that a monetary system which has not evolved naturally will be misused in order to create inflation. There is an enormous danger that the maladjustments arising during the production process either because of a «policy of full employment at any price» or because of struggle between different groups in the economy or else for other reasons will be temporarily veiled by inflationary measures such as an expansion of credit, devaluation, a policy of low interest rates etc. The makers of such a monetary policy may be compared with an architect who concentrates his attention on the roof rather than on providing the building with solid foundations.

Yet apart from a deliberately inflationary monetary policy, the events to date have already revealed the contradiction in that industry needs the guiding hand of monetary stability even though an unstable monetary value seems to be inherent in modern industrial life – as the cyclical fluctuations have revealed.

4. What is the explanation for monetary instability? The main reason is the transformation of banks into «mints». Since the 18th century, money has been created on a growing

scale through the provision of loans by the banks – only to disappear when these loans are repaid to the latter. This has been the case with bank-notes and the deposit money of central and private banks. These are the two most significant types of money at the present time. The fluctuations in the volume of bank credits have also altered the money supply. Credit expansion implies an increase in the quantity of money circulating outside banks, whereas restraint in the granting of loans and the repayment of old loans engender a smaller money supply. Every day, money is put into circulation by bank loans or withdrawn by the repayment of loans.

In former times, money was mostly created in a different way: by converting goods into money – for example by making metal into coins or by a central bank minting gold and silver for the purchase of goods. Since the 19th century, this third monetary system has assumed ever greater importance. Many authors have described the extent to which this elasticity of money encouraged investment during the Industrial Revolution. Without this phenomenon, industrialization would have proceeded at a much slower pace. At the same time, however, this also marks the origin of our unstable money, the trend towards greater inflation and the deflationary contraction of the money. The supply of money became dependent on the liquidity and readiness of banks to lend as well as on the demand for credit, i. e. the entrepreneurs' propensity to invest. Not all forms of saving under this monetary system produce a corresponding expansion in bank loans.

Under the free competitive system, we must also reckon with the sensitivity of the price system to unstable currencies. If unstable monetary arrangements such as persisted in the first half of the 20th century were to be incorporated into the competitive systems, their economic processes would also lead to aberrations and to crises caused by unemployment . . .

Open Markets

1. The disruption of supply and demand is the method previously and currently most used in order to impede or reverse the strong movement towards competition, which makes itself felt in an industrialized economy. Modern governments and private or semi-official pressure groups alike have applied an unusually large set of instruments in order to terminate supply or demand. Import bans or prohibitive custom duties or export monopolies favour the domestic producers at the expense of their foreign competitors by bringing about a local disruption of supply. Prohibitions of investment, restrictions on the cultivation of crops, bans on the construction of houses and so forth all produce a similar impact. The list should also include the interdiction of migration and movement, the restriction of a free choice of profession, the introduction of licensing systems with qualification tests for trade and industry, and the creation of a *numerus clausus* as well as the ban on the simultaneous pursuit of several occupations.

We have so far spoken of measures adopted by the State to eliminate outsiders. But private pressure groups and individual monopolistic enterprises have also developed a method of inhibiting and keeping out producers from other countries.

Mention should also be made of the singular schemes for excluding such persons whereby governmental and private agencies cooperate and the State provides support for private entrepreneurs so that they can erect a dam against the flow of supplies. This has happened, for instance, in patent law and in trade-mark protection with retail price maintenance.

In the Middle Ages and under mercantilism, highly effective procedures operated to obstruct the flow of labour and capital into a given trade. Similar methods were perfected during the Industrial Revolution and these proved to be no less successful.

2. Where an enterprise receives the exclusive privilege of carrying on a certain trade such as the postal authority in respect of the delivery of mail or the central bank in respect of the issue of bank-notes, this act of exclusion immediately establishes a monopoly and undoub-

tedly brings about the debarring of all non-monopolistic forms of marketing. In many cases, however, the situation does not involve the elimination of supplies for an individual merchant but, instead, in favour of a large number of suppliers. This happens, for example, in limits on admissions to the retail trade, the investment bans for whole branches of industry or the restrictions on the cultivating of sugar beet and similar produce. Is the protection of the markets in such cases compatible with the competitive system? Is it not possible that competitors may appear in exclusive markets as de facto happened with tobacco supplies in Germany in the Thirties? Is it really true that the partial closure of markets is incompatible with unrestricted competition and that it is necessary for the realization of such competition to keep all markets as open as possible?

The answer to this is that the competitive mechanism can operate effectively within a closed market. Nevertheless, the makers of economic policy must be governed by the principle of keeping the markets open, since their closure would harbour the acute danger of thwarting the possibility of untrammelled competition. Two factors tend to operate in this direction.

Firstly, the elimination of supply and demand greatly facilitates the formation of monopolies. When investment in cement works is prohibited, for example, or admission to a craft is restricted, there is every chance that monopolies will arise. Where import or investment prohibitions restrict steel supplies, then the cartels for steel stand stronger than ever. Conversely, it is difficult to maintain monopolies and to stop oligopolies from becoming competitive if there are no marketing restrictions and if import bans, licensing restrictions, investment prohibitions etc are abandoned. For these reasons, freedom of supply and demand form a prior condition for the competitive system in modern industry.

Equal importance attaches to the second factor. Even if unrestricted competition emerges in individual closed markets, the link between the markets is nevertheless disrupted; and the whole system of perfect competition proves unable to function. Where, for example, the State prohibits investment in machine-tool factories, there may be competition between these factories but the ban will nevertheless prevent the flow of so much capital, labour, iron and other materials into the construction of machine-tools as would have been possible pursuant to the prices offered. The outcome will be a greater shortage of machine-tools than in the event of a cancellation of the investment ban. The attainment of a general balance, i. e. the coordination of the numerous markets and branches of production, does not succeed in toto when investment bans and other restrictive measures are in force. The functions of control and selection, which prices exercise under an open unrestricted system and which consumer themselves also exercise via price, are partly discharged by the same agencies which stipulate the restrictions. Furthermore, certain revenues in the trades governed by limited admission would be lost if the markets were thrown open.

Hence, the principle remains that the establishment of a competitive system presupposes a free flow of supply and demand. There are, however, a few exceptions to this such as the granting of the sole right of issuing notes to a central bank.

3. The State must not confine its activities to the granting of licences to all interested individuals for the exercise of a trade; to the cancelling of investment bans, admission embargos, privileges and other constraints; the establishing of freedom of trade and of movement; the avoiding of governmental bans on imports and thus in general the avoiding of State restrictions in order to leave the process of selection to the price system prevailing under perfect competition. On the contrary, it is also necessary to ensure that the restricting of the market by private pressure groups does not take place. What is the use of officially decreed freedom of trade if it is annulled in practice by the policies of the pressure groups? How can one talk of freedom of trade if a rolling mill cannot be set up because the existing cartel prevents this by dint of its militant measures? All kinds of preventive competition should be ruled out: embargos of every kind, loyalty discounts, exclusive contracts and aggressive pricing to scare off outsiders – all of them intended to deter or destroy.

Keeping markets open helps to promote a country's economy. Hence, private pressure groups cannot be given the right to eradicate this. That right forms part of regulative policy and it must not be left to private persons. This also illustrates the difference to the system of *laissez-faire* under which private pressure groups had the right of establishment but also the right of restricting markets by militant methods.

4. The implementation of this principle in the various sectors of the economy involves a number of individual problems. The issue may be illustrated by taking two examples, tariffs and patents.

What should be our attitude to protective tariffs, i. e. those tariffs which do not exercise a prohibitive effect and thus do not resemble import bans? Custom duties of that kind do not bar supplies. We need only think back to most of the tariffs which existed prior to 1914 within the framework of the «Central European system of trade agreements».

Such tariffs do not directly destroy the system for regulating competition. They operate like an increase in the distance between countries: they bring about a shift in relative prices. But they do not make it impossible for the price system under perfect competition to steer the economy. To that extent, tariffs are compatible with the competitive system. Moreover, the transition from the system of import bans or import licences to the tariff system represents a step in the direction of a freely competitive system.

Indirectly, however, tariffs can endanger the competitive system. This occurs when they facilitate the formation of monopolies. Clearly, tariffs can augment the potential cartelization of a tariff-protected industry – often enabling the country concerned to exclude itself as a sales outlet from world markets and to dominate them in monopolistic fashion. The history of the German iron industry is replete with examples of this kind. In these instances, the reduction of customs duties may furnish a means of eliminating monopolistic trends and help to organize the competitive system. In many sectors of German industry, cartels would disappear immediately if tariffs were to go. An appropriate trade policy is an essential step towards achieving a sound system for regulating competition.

5. Those types of economy which are incompatible with the competitive system and indeed alien to it often came into being in connection with contemporary patent law. This also ranks among the numerous legal institutions which produced different results to those intended by the law-makers. The legislation was intended to promote technical advances as well as to protect and remunerate the inventor. It remains to be seen whether these aims were in fact accomplished.

Despite certain legal precautions, patent law has unexpectedly triggered powerful tendencies towards the formation of monopolies and concentration processes in industry. These trends have resulted from the nature of a patent in instituting an exclusive right to manufacture an article and to market, use and sell it. True, many patents do not restrict the flow of supplies. These are patents which only cover a small segment of an article's production process and which may be obviated by other production methods, substitutes etc. But there also exists another group of patents, i. e. the basic patents which exclude the flow of goods. These include *inter alia* the well-known Telefunken patents for the production of radio valves or the benzo-purpurin (Scarlet red) patent of 1884, which later assumed great importance in the chemical industry.

The exclusion of supplies by patents has contributed in two ways towards encouraging business concentration. Patents may confer an individual monopoly on single firms such as often happens in the fine-mechanical industry. Secondly, patents have initiated or strengthened the formation of cartels or groups of companies. This impact has been more significant. And we are not only thinking of the patent cartels or patent trusts or patent groups. The exchange of licences facilitates the formation of cartels: the risk which a member runs of losing his entitlement to certain patents in the event of his quitting a cartel helps to keep the latter going. Patents have also become absolutely indispensable in establishing modern groups of companies, particularly as regards their expansion and struggles against

outsiders. As G. Gather has observed, the driving force of patents must be sought and appreciated wherever types of industrial concentration develop which do not allow the general public to hear anything of the quest for patent power or fundamental licensing agreements even though they substantially owe their existence, design and organization to these factors. It is difficult to compute their number: they only manifest themselves as inherent trends and latent possibilities. Generally speaking, the spread of monopolies and oligopolies in our modern economy has been greatly influenced by trade-mark protection, resale price maintenance and suggestive advertizing. An example which immediately springs to mind is the formation of multi-company groups in the chemical, washing powder and cigarette industries. The patents office is the heart of these modern business groups. Court practice has greatly promoted the conditions for the inception and acceleration of the industrial concentration process whilst curbing or nullifying those forces in favour of unrestricted competition.

6. Any patents policy which draws the appropriate conclusions from this experience forms – together with an analogous treatment of trade-mark protection, resale price maintenance and suggestive advertizing – an important part of an economic policy directed towards realizing a freely competitive system. Its aim consists in limiting or removing the restriction of supplies inherent in the granting of a patent. How is that possible? Can one adhere to the basic idea underlying contemporary patent law i.e. the granting of the exclusive right to exploit an invention? In that case, it would be necessary to relax substantially the constraints on supplies imposed by the contemporary legislation and court-practice of the industrialized States. Numerous suggestions have been advanced in this field: the curtailment of the term of protection and the development of compulsory licensing.

Whether or not the easing of exclusive rights will suffice is another matter. Perhaps the conferment of such rights and the concomitant curtailment of supplies should be waived in favour of a system obliging the patentee to allow any interested person with serious intentions to use the invention upon payment of an appropriate licence-fee. As with all other monopolies, there would be a statutory obligation to enter into a contractual agreement with the patent office determining the terms if the two sides failed to agree. Several of the older suggestions about patents could be developed in this direction.

Private Property

1. One of the fundamental errors in the economic debate and policy of the 19th and early 20th century lay in the expectation of finding the solution to the social and economic questions in the system for regulating property. This directed policy-makers to the wrong point of attachment – as has been explained above. Yet even though the basic problem of economic policy must be approached from a thoroughly different angle, the question of property possesses remarkable economic significance. This is not only because collective ownership of essential parts of the productive apparatus represents a highly effective instrument of control in the hands of a leading class, but also because it is invariably linked to the central direction of the economic process and brings into existence social problems which cannot be resolved . . .

2. Does the institution of private property furnish a guarantee that a free competitive system will be introduced? Apparently not. A glance at everyday reality shows that private property is compatible with very different economic systems. When the whole economic process is carried out in an «independent» economy, private property has quite a different status to that in a free exchange economy where, for example, the owner of a salt mine or a railway enjoys a monopoly in the salt or transport market. Again, the status of property rights differs when privately owned shoe factories are competing against each other in the

markets. Yet another different situation prevails when private property is connected with the central direction of a certain branch such as shoe production.

Let us take a further specific example and assume that a large private car-manufacturing plant provides the largest demand for labour in a small town to the point of enjoying a partial monopoly. In this instance, private property confers a position of significant power because the proprietor is a partial monopolist in his demand for labour. The powerful force which the workers have to face is even stronger when the car factory upon which they depend is harnessed to a centrally administered economy. What we have in mind here is a specific case, which was partly realized in Germany. The car works remained in private ownership, but the responsibility for directing car production and labour passed to public departments. The workers were now officially enlisted for service in the works. They were dependent on the public departments controlling the productive process under an economic system in which central direction was linked to private ownership. All that differs considerably from a situation where numerous engineering companies and car works located in the same town compete with each other in the demand for labour, thus altering the economic and social substance of private property.

Depending on the given market structure, private property can thus reveal quite a different character; and the function of proprietorial rights can change accordingly. As analysis has shown, private property leads to grave damage in monopolistic markets. The private owners of factories or private combines, cartels and employers' associations – backed by the position conferred by private property – have often made full use of their available power against the workers, their customers and competitors. In many cases, this power proved so strong that the guarantees of a constitutional State did not suffice to limit it. Hence, it was understandable that many critics of the prevailing economic system in the 19th and early 20th century mainly censured private ownership of the means of production. These strictures were often justifiable.

It is necessary to consider in all its shrillness the discord between the need for the institution and its attendant problems. For some two centuries, it has been customary to take a one-sided view of the damage caused and to conclude from the criticism of private property that collective ownership ought to be introduced. *Rousseau* had declared that every individual together with all his rights should merge into the total scheme of things and that everyone should devote himself to this with his whole person and all his resources including any property which he might own. Even *Mirabeau* had some critical remarks to make about members of the propertied class being the agents or economists of the body of the economy. When *Marx* later accused the capitalists owning the means of production of exploitation, he overlooked one simple fact: «private property» has various meanings, depending on the type of market one is talking about. The essential question is whether market structures and monetary systems can be realized in which «exploitation» is rendered impossible and the whole economic process balanced and which do not lead to the acquisition of power. In other words, can private property become an economically and socially useful instrument in the national scheme of things?

3. In order to resolve this urgent question, we must clarify the real significance of private property if it is to fulfil its role in the economy. Under a competitive economy, the price system resembles a radio set into whose microphone thousands of well-funded purchasers voice their wishes. On the other side of the set, thousands of proprietors obtain sound advice about how to exercise their property rights in optimal fashion in the private sector. Without realizing it, they simultaneously receive instructions about how to behave correctly from the standpoint of the national economy. The individual entrepreneur bases his decisions regarding the type, method and scale of production on these instructions. If he does not succeed – at least over the long term – in achieving average results, the mechanism of free competition will inexorably deprive him of his hold over the means of production . . . Hence, private ownership under a system of unrestricted competition signifies:

- a) freedom and power of disposition in the service of the national economy; and the
- b) incapacity to limit the freedom and power of disposition of the other proprietors at the expense of the population as a whole.

Under a system of unrestricted competition, there exists a balance in the distribution of economic power between private owners.

But this only applies where the character of private property really conforms with the competitive system. It does not hold true when one of the multifarious forms of monopoly in supply and demand arises, since such positions of power falsify the economic purport of private property. As they contradict the intentions of the overall system, this invariably inflicts severe damage on the economic process. At such a juncture, private property does indeed appear unsocial.

It is only under a competitive system that the much cited proposition applies: private property benefits not only the owner but also the non-owner. It achieves this through the superior economic efficiency of the competitive system, the competition between the various proprietors and the choice of opportunities open to those in search of work so that they do not become unilaterally dependent.

Just as the private ownership of capital goods is a prerequisite for a competitive system, so the latter forms a prior condition for ensuring that the private ownership of those capital goods does not engender economic and social grievances. Private ownership of the means of production needs to be controlled by one's competitors. At this stage, particular importance attaches to interdependence between all economic measures. If the other principles whose application brings about the attainment of a freely competitive system are really observed, the private ownership of capital goods and the power of disposition over them exercises a pre-eminent regulative and social function. But if the other principles are not respected and monopolies arise so that the sharp edge of competition is lacking, then the power of control over private property has to be curtailed.

4. Obviously, we must analyze the relationship between property and other spheres of human order such as the social fabric or system of government. This study would reveal that private property is fundamental to the preservation of individual freedom. Where collective ownership of the means of production predominates, there arises a gigantic economic force which crushes all manifestations of human liberty and individuality. The outcome of this dependence is that the position of the individual in the social order becomes insignificant and indeed helpless. The same applies to the State. Both the people being ruled and the functionaries and officials are deprived of their independence.

The position occupied by the competitive system in the interdependence existing between the various economic orders may be seen here in a special light. Only the competitive system makes the institution of private property tolerable in the long run in a modern industrialized economy. By the same token, private ownership forms a precondition for a free State and a free social order.

Freedom to Contract

1. Contractual freedom is obviously central to the realization of a competitive system. If individual households and business enterprises are unable to choose and examine the available opportunities and then to conclude agreements and if they simply carry out orders or receive their allocated rations, then there will be no opportunity for competition to emerge. On the other hand, freedom to contract has also served to eliminate competition and to establish monopolistic positions or to strengthen and exploit them. The holders of monopolies often draw attention to the legally guaranteed freedom to contract and the powers thereby conferred.

What is the position in regard to freedom to contract? It is necessary for translating the competitive system into reality? In what form? Is it dispensable?

Let us consider the salient facts of the economy and of economic policy. These point to the following conclusions: firstly, freedom to contract may serve not only to promote but also to destroy competition. This question is dealt with under (2). Secondly, freedom to contract may have different implications in practice, depending on the given economic structures (3). The reply to these questions is set out under (4).

2. The major reforms of late 18th and early 19th centuries – when freedom to contract gained wide acceptance – lent considerable strength to the competitive element in the economic systems. When that period began to experience the innumerable cases of compulsory labour and the guild regulations with their restrictions on freedom to contract or the prohibitions on the free acquisition of landed property and the setting of prices by the Government or municipal authorities, then the system of free competition based on efficiency began to win the upper hand. As long as the peasants were obliged to work in a certain district and to grind their corn at fixed prices, no competition could develop between the mills. This only came into being when freedom to contract was accorded.

Yet even at this early stage, certain facts at variance with competition made their appearance.

It became clear, for example, that peasants freed from compulsory service and able to conclude free employment contracts were in effect far from being free. They had to rely on some major property owner in the local district who enjoyed a monopoly in the demand for farm labourers. Moreover, the social condition of these labourers had changed little since earlier times. Their fate was that they had to vie for the jobs in the large enterprises, whose monopoly of demand on the employment market permitted a unilateral stipulation of wages and terms. Despite the freedom to contract, there thus persisted a superiority and predominant force on one side of the market unmatched by the competition of wider demand. Similar situations revealed themselves in other industrial concerns, thus ushering in great social distress among factory workers during the Industrial Revolution – despite the existence of freedom to contract. (The makers of social policy faced a double-edged and onerous problem. The elimination of freedom to contract and the reintroduction of the old relationships were unenforceable and would have caused a deterioration of conditions in practice. Moreover, the retention of complete freedom to contract seemed risky because abuses had occurred under this system).

In many instances, freedom to contract in the hands of private entrepreneurs thus became something different to what one had expected in earlier times. It turned out that contractual freedom did not necessarily generate competition on both sides of the market so that such freedom only operated *pro forma*.

Furthermore, freedom to contract also conduced to get rid of competition, e. g. in the establishment of cartels and other monopolistic groups. The operation of the principle of freedom to contract resulted in the abolition of the central principle of the competitive system. During the age of *laissez-faire*, the law makers found no means of coping with this serious problem. We need only recall the words of *Heckscher*, who pointed out that liberalism had never clearly decided in favour of free competition *à tout prix* against freedom to contract *à tout prix* or for the latter against the former. The economic policy of *laissez-faire* gave private individuals the freedom to determine quite freely, irrespective of any basic economic decisions or rules, the form in which the economic process would operate and to do so by means of contractual agreement.

3. This brings us to the next question: how does the pattern of the economic system affect the law applicable to freedom to contract?

Let us consider a number of cases. Take, for example, a municipal housing office which allocates a certain dwelling to a lessee and stipulates that the house-owner should conclude a lease with him whereby the rent is officially fixed by the local authorities. Or take the case of a coal cartel which dominates a market, sells coal pursuant to its unilaterally determined prices to a dealer who undertakes in turn to sell it at prices laid down by the cartel. Another

illustration would be a steel merchant who decides after receiving numerous offers and in competition with other dealers to purchase certain steel products from a number of firms at prices which he negotiates and contracts with them.

All three cases are governed by the same contractual law, i. e. the provisions of the German Civil Code. In the first illustration, the contract merely implements the «regulations» of the central supervisory body, i. e. the housing office. No contractual freedom exists either in regard to the choice of contracting partner or to the determination of the contractual terms. In the second illustration, the contract is concluded without any instruction from an official body. Nevertheless, the contract is a dictated contract. The coal merchant is not free to choose the other contracting party nor can he negotiate freely the prices and terms for the purchase and resale of the coal. He is even obliged to accept such general business terms imposed by the cartel as restrict or rule out the application of national laws. The merchant has become dependent on a marketing monopolist and the arbitrarily imposed contract is tantamount to «regulations». Only in the third instance can contractual freedom be said to exist, not only *pro forma* but also *de facto*. The existence of free competition establishes a kind of equilibrium on the markets, thus permitting a free choice of contracting party and the negotiation of the contractual terms.

What are the implications of this? Wherever a central administrative body exists, it is the directions of this controlling authority which regulate the everyday economic process and not the terms of the contract. That even holds true when a free law of contract is in force in that particular country. But where a type of free exchange system has been realized, the everyday events of economic life such as the flow of goods and services are governed by contracts – albeit contracts of a highly differing character depending on the kind of market in question. The contract signed under a monopoly of supply, for example, would be quite different to that under a system of unrestricted competition.

The substance of a legal institution is contingent on the form in which business is transacted. We found this in the law on property and we find it now in the law of contract. (Admittedly, economic structures are determined by legal policy so that reciprocal dependence does in fact exist).

4. The findings under 2) and 3) show whether freedom to contract will emerge and, if so, what form it should take in order to establish a system to regulate competition.

Firstly, it is in fact quite indispensable. The absence of free individual contracts such as derive from the economic planning of private households and business firms makes it impossible to steer the everyday productive and distributive process by means of free competition. The direction of the economic process by regulations on compulsory service, allocations, instructions on production and confiscations rules out any control of the economy through unrestricted competition.

Secondly, the limits which must be drawn so that freedom to contract may promote the establishment of the system have now become clear:

a) Freedom to contract must not be used for the purpose of entering into contracts which restrict or eliminate freedom to contract! It should not serve to set up monopolies or to reinforce a monopolistic position. Monopolies eliminate the free choice of party to a transaction and make third parties dependent on the will of the monopoly.

The members of cartels like to quote the principle of freedom to contract in support of their status. This is, however, quite unjustifiable since it must not be used to create situations which remove freedom and unrestricted competition. Entrepreneurs must not be permitted to set up economic enterprises militating against the fundamental decision on a country's economic system.

b) Similarly, freedom to contract should only be accorded at such points in the economic process where free competition rules. Let us recall our example of the coal cartel and its counterpart, the steel merchant. Freedom to contract under a monopoly of supply or demand results in dictated contracts and not in the envisaged steering of the overall economic

process. What is lacking is the control mechanism of perfect competition. For that reason, another control becomes necessary, namely government supervision of monopolies with compulsory contracting and the determination of prices and general conditions of business by a Monopolies Office.

The principle of freedom to contract should be classed along with the system for regulating competition. It helps to establish the latter and, by the same token, fulfils its true purpose within the framework of the competitive system. Nevertheless, it must not transcend the bounds of the system by setting up powerful economic bodies or by protecting an exercise of undue economic power or abuse of power.

Liability

1. Those who benefit from something must also be prepared to bear a loss if need be. Even under the older legal provisions, this principle governed the handling of liability i. e. the possibility of seizing a debtor's assets. It was still in regular operation at the outset of industrialization. But there then began an era of increasing restraints on liability. The general terms of trade drawn up by the central associations usually tried to curtail the liability of their members and ample use was later made of the legal possibilities available under company law by setting up joint stock companies or limited liability companies. Today, private individuals and business enterprises constantly encounter limitations of liability: when people travel by train, for example, or use the service of a bank; or when a firm buys a machine or advances a claim against a limited liability company. The scope for liability diminished considerably in the epochs of late *laissez-faire* and of experiment. Indeed, the current co-existence of limited and unlimited liability prompts the questions: what is the purpose of liability? When is unlimited liability advisable and when limited liability?

2. The functioning of this legal institution turns on the economic system, either already existent in concrete form or – in the case of economic policy – on the system to be created. Hence, it involves a question pertaining to the economic order which was not formerly posed, but which can no longer be avoided.

When setting up an overall economic order, the subject of liability must be assigned a major role. After all, its aim is to permit or facilitate a natural selection of enterprises and of managers. It is also intended to ensure that the available capital is handled with due care. Investments are effected with all the more solicitude, the greater the responsible party's liability for the investment. To this extent, liability exercises a prophylactic effect in curbing a waste of capital and it forces interested parties to explore the market carefully. Furthermore, the principle of liability holds special importance for the competitive system because it hinders an affiliation of other firms which sometimes takes place out of lust for power. The important factor is costing. Anyone who assumes complete liability for a newly purchased enterprise will have to consider very carefully whether or not to buy the firm. The situation becomes quite different if only incomplete liability exists and one can gain control over the business behind the protective shield of limited liability. Companies protected by some form of limited liability have contributed on a large scale to the formation of combines. In other words, as universal an application as possible of liability would help to inhibit business concentration. The principle of liability serves to promote a free competitive system and to deter the emergence of alien forms of marketing. At the same time, liability is necessary in order to render competition based on efficiency workable within the system. Both these implications are significant. Without the personal responsibility of the individual participants, a system to regulate competition has just as little chance to function well as when adequate marketing forms or monetary systems are lacking.

Under perfect competition, trade and industry depend upon the demand created by the recipients of incomes in that suppliers tend to base their prices on those cited by their

competitors. Liability forms part of the steering mechanism of unrestricted competition. It represents an indispensable regulative institution in the competitive set-up. As *Röpke* has pointed out, the competitive system presupposes that the attainment of profitability will only be possible by means of an equivalent economic performance and that a blunder will be mercilessly penalized by losses and finally by bankruptcy. Steps must be taken to prevent both the surreptitious enjoyment of income without a corresponding performance and the non-punishment of blunders by passing on the losses to others. Hence, the precept applicable to the system for regulating competition reads: those who are accountable for the plans and measures adopted by businesses, factories and private families must be accountable in law (the liability principle).

In other words, limitations on liability as for example in the provisions of company law governing the competitive system are only permissible in cases where an investor is not responsible for the management of an enterprise or to a limited extent only. Examples of this would be a small-scale shareholder or a limited partner. But if the dependent juridical person alone is liable in a large undertaking whilst the manager makes all the major decisions, such a limitation of liability is incompatible with the competitive system because the person accountable for planning has shifted the responsibility on to someone else. In a competitive system, the person with the controlling influence is the liable party.

3. The development of liability provisions during the last few decades has been marked by inconsistency. Entrepreneurs have acquired greater opportunities for avoiding liability, for instance by clothing their business in an appropriate company form or by adopting the general terms of business favourable to them. This has fostered business concentration and impaired the viability of the price system. The selection method and control through liability have been repressed – both without any replacement. As a result, the steering of the economic process has passed more and more into the hands of a group of directors and functionaries, who are neither proprietors nor subject to the instructions of the central administrative agencies. Alternatively, it lies in the hands of majority shareholders able to dominate several or numerous joint-stock companies without being discernible as such and therefore in a position to preserve their anonymous power.

The phenomenon that those in a decisive position for directing the economy are not liable in law has also arisen in another way. This happens when central planning agencies give instructions to firms which are in fact privately owned. In such an instance, it is pointless to maintain liability. Under such central direction of the economy, a different selection of personnel takes place and it is not the managers who control investment but the competent officials at the central planning agency. Bankruptcy has no place here. The Government's planning departments may, for example, order all farmers to break up part of their fields and plant cereals there. It later comes to light that the reduction in pasturage and in the stock of cattle was an error of judgment and that bread-grain must be cut in price in order to sell it. Such occurrences very often take place in economies which combine private property with central planning controls. This was, for example, the situation in Germany between 1936 and 1948. The directions emanated from central planning agencies, but the risks were borne by the firms themselves. This division also results in plans and instructions which are neither drawn up nor issued with the requisite degree of circumspection, the reason being that those responsible do not assume any liability.

Neither of these methods of separating the authority to issue orders from liability for what happens has proved to be a success in practice. They were only able to flourish because of the general failure to recognize the overall function of liability. This prevalence of separation, which is intolerable in the long run, can only be overcome by expanding the scale of liability.

Otherwise, one is merely aiding and abetting the acceptance of collective property and a centrally controlled economy . . .

1. The propensity of entrepreneurs to invest has of times declined very significantly in most industrialized countries during recent decades. That is one of the gravest phenomena of contemporary economic life, since a lack of investment generates unemployment or underemployment. How can one explain this reluctance? The customary reply is: modern industrial advances have reduced the opportunities for investment. The more railways, factories, machines and other means of production there exist in the world, the fewer the investment tasks remaining to be fulfilled because a saturation point has been reached.

This school of thought, voiced originally *inter alia* by *Sismondi* and popular during periods of protracted recession, gained a particularly large number of adherents during the Great Depression after 1929. It led to the demand, put forward with great success by *Keynes* and his school, that the State should intervene in the absence of adequate fresh investment in order to obviate a permanent recession. (The State should pursue a policy of low rates of interest, expansion of credit, placing of public orders, budgetary deficits and the creation of jobs.)

2. If that explanation were correct, investment opportunities would inevitably disappear. If the only rescue were for the State to assume the tasks formerly undertaken by the entrepreneurs, then the result would be a virtually hopeless situation. Although government investments may bring about the use of more capital goods and labour, the State is unable to regulate the correct dosage of investment. The inevitable outcome – the «development law of capitalism» – would press people into unbalanced investment with their efforts contributing little towards any real improvement in the supply of consumer goods.

3. However, the explanation for the decline in investment propensity and in investment itself does not lie in the contraction of investment opportunities. We are not living in an economically satiated world.

Investment opportunities will endure as long as people experience the shortage of goods with particular exigency. Investment may be effected up to the point where everyone's needs have been satisfied by the productive apparatus. But we have still an immeasurably long distance to traverse before we reach that point. – Let us illustrate this by reference to a small segment of the economy. Only a tiny part of Europe possesses a highly intensive form of farming: the countries of Belgium, Denmark and the Netherlands. They account for about one per cent of Europe's superficial area. A great deal of investment will be necessary in order to introduce intensive methods in other areas of European farming of the maximum scale. There can be absolutely no talk either here or elsewhere in the world of having reached saturation levels in regard to the means of production.

4. Clearly, the question must be recast. How has it come about that recent decades have seen such a modest propensity to invest even though enormous opportunities for investment do exist in practice?

Our search for the answer takes us to the source from which all economic activity flows: economic planning. If we approach our subject from this angle, it will be ascertained that two factors accounted for the unwillingness to invest.

a) The price of capital goods and labour compared with that of merchandise made investment appear inappropriate. Let us put that another way. The prices offered were such as to inhibit investment. Where the prices of capital goods were kept high by means of cartels or where wages were fixed at a high level due to state intervention, that could result in price ratios which rendered investment unattractive. The decisive factor in this situation was solely the planning data i. e. the expectations. The heads of firms entertain certain expectations about the pricing of their products. On the one hand, they encounter certain price levels for capital goods and wages and this shapes their decision. That may be demonstrated by a simple illustration. In the critical year 1931, Berlin's building contractors faced relatively rigid prices for their means of production such as iron and cement (as these had been fixed by cartels) and relatively rigid wages, whereas on the other hand the price of

houses was falling rapidly. For this reason alone, there prevailed a notable disinclination to build. This furnished further proof of the fundamental truth that the economic process – in this case, investment – can only be steered in commensurate fashion by pricing if the prices quoted accurately reflect the given shortages so that the ratio between the price of capital goods and that of the products is not impaired.

b) To this must be added a second factor of equal importance. A certain consistency of data is necessary so as to enable major investments to be incorporated within planning. Take the case of an engineering entrepreneur keen to expand his factory whenever this appears to be opportune on the basis of current prices and price ratios. How does he feel on contemplating the eventuality that sudden currency devaluations will give his foreign competitors a sales advantage or that his sales outlets will dry up because of protective tariffs or that his previous profits will melt away under the impact of changes in taxation in his own country? The remarkable instability peculiar to empirical policies such as those adopted for currency matters, trade, taxation and wages by the industrial countries in recent decades has engendered a significant heightening of uncertainty. The hazards have become too great, the interval between planning data and actual data too extended.

As researches in American factories have shown, producers only invest in the purchase of new machines if the invested capital can be amortized within three to five years. In the housing sector, the amortization periods are much longer. In Germany, many entrepreneurs were only willing to invest in the Forties if their invested capital could be amortized within three years. The instability of economic policy forced them to cling exclusively to such investments as swiftly recouped the disbursed funds due to the high level of profitability. The consequence of this was a sharp fall in the number of planned and implemented investments. The violent fluctuations in economic policy, with frequent changes from one day to the next, created a wide measure of insecurity and this – together with distorted price ratios – has discouraged many investments. The atmosphere of confidence is absent.

5. What inferences should be drawn from such experience for economic policy and in particular for a policy designed to establish a competitive system? A certain consistency in economic policy is necessary in order to initiate a sufficient volume of investment. Without this permanence, even the competitive system would not work.

A system of free competition is capable of bringing about an accurate coordination of investments in the long run, because it possesses an instrument in the form of the price mechanism with which to determine and then rectify maladjustments. In this respect, it enjoys superiority over all other systems. Moreover, it overcomes the disinclination of entrepreneurs to invest wherever this stems from the retention of the price of capital-goods i. e. from a shift in the ratios between prices and costs.

But if economic policy is not marked by sufficient permanence, the competitive system cannot function, either. Considerable importance attaches to long-term arrangements for taxes, trade agreements, currency exchange rates etc. As long as they are unreliable, one cannot count on an adequate propensity to invest. Economic plans would then lack the long-term nature needed to develop and maintain modern industrial production. Given a sufficiently steadfast economic policy, investments would take place even if amortization were expected to take fifteen or twenty years. Entrepreneurs have to bear commercial risks and to adapt to the fluctuating fortunes of their individual businesses. They must reckon continuously with fluctuations in prices and adapt to these ups and downs. There will always be a gap between planning and actual data as long as the economy grows. But that lacuna ought not to be widened so much by such swift and varied changes in economic policy as to discourage those investments which only secure a return after many years have passed.

Constancy is a prime essential for economic policy under a system of free competition. This policy constitutes an appropriate framework for the productive process taking place under a country's economic constitution. For this reason, let us adhere to the framework and think very carefully before altering it.

6. Consistency in economic policy is also of significance for the competitive system for another reason.

Past experience in countries such as Germany has shown that rapid changes in economic policy foster the formation of multi-company groups. The greater the risk involved, the greater the tendency to form a group embracing companies from various branches or various parts of the same branch. The uncertainty created by a swift change in economic policy provides an impetus for acquiring an interest in firms of other branches of production or for buying them outright. An example would be a cotton-spinning mill which invests in a coal merchant's firm, an engineering company and a candle factory. This is one of the numerous causes – brought about by economic policy itself – for the present concentration in industry. The more unswerving economic policy remains, the less reason there will be for business concentration and the greater the promotion of the free competitive system.

Unity of Constitutive Principles

1. By constitutive principles, we mean those principles making up a country's economic constitution whose joint application at a specific point in history establishes a certain envisaged economic system. This is done by creating conditions which serve to bring that system into being. Hence, all the principles in question help to promote the adoption of an overall economic decision and also represent the instruments used in practice to enforce that overall decision.

Thus, we are not talking about either legal dogmas or about natural law. Some of the principles such as those of freedom to contract, liability or private property have been developed by philosophers and jurists as purely legal principles, for example as tenets of natural law. However, the regulative framework with which we are concerned here did not emanate from natural law or the higher plane of dogmatic axioms. For example, the call for the establishment of private property is often deduced from the nature of man and justified as a command of natural law. That is not the case here. Private property proved to be essential in order to constitute a system for regulating competition together with the other principles. Evidently, the competitive system not only exercises an impact on the economy, but also bears upon the interdependence of the systems, the social and legal orders.

2. The emphasis among all these principles lies upon their positive aim.

Critical voices have often been heard about the extraordinary difficulty in providing appropriate steering controls for the modern economic process. A more important consideration is the necessity of translating such controls into reality. All the constitutive principles of which we are talking jointly serve to accomplish this goal. If for example all the other principles were to be realized – though accompanied by a lack of steadfastness in economic policy – the consequence would be an inadequate volume of investment and the absence of sufficient competing prices needed to steer the economic process.

The industrial concentration which has been proliferating for decades ought also to be combated with positive measures. It would be difficult to limit the size of firms by direct intervention such as stipulating a maximum amount of capital or a maximum number of workmen or in fact prohibiting the creation of multi-company groups. However, inasmuch as these groups are monopolies, they are governed by the same rules applicable to any monopoly: they should be dissolved wherever possible, or else subjected to monopoly controls. In point of fact, the economic policy pursued under a competitive system prevents the formation of groups of companies by establishing the appropriate conditions, i. e. reforming the patent law, making markets accessible, extending liability, introducing an appropriately limited form of freedom to contract and acting in accordance with the other valid principles with special emphasis on consistency in economic policy.

3. The unity of the principles is so pronounced that some of them would simply fail in their purpose if applied in isolation. We have noted this in regard to the property issue. It is difficult to call for private ownership of the means of production when the State simultaneously insists on restraining the competitors by virtue of its law of contract, limitations of liability, trade policy, prohibitions on investment, trade-mark protection and patent law. When taken together with the other principles, however, private property has a real and positive purpose.

Competition Policy in an Industrial Society

Ernst-Joachim Mestmäcker

1973

1. The expectations associated with the concept of a liberal economic policy reflect the role assigned to the State in respect of its relations with society. In the conservative tradition, economic power affords just another reason for demanding an ever stronger State. If the admirers of sovereign power find the democratic State unworthy of more power because it has degenerated into a «mere constitutional State», they then proceed to invest the modern corporation or the modern technology («technische Realisation») with the glamour of irresistible power. In the socialist tradition, private property of the means of production is identified with economic, social and political power which cannot be controlled but must be overcome by the abolition of the market economy. Both these schools of thought see liberal policy in the final analysis as *laissez-faire*. Any endeavours to go beyond that seem, at best, sheer optimism and – on a less charitable view – political ideology. The fundamental aspect of liberalism deriving economic and social systems from individual actions becomes mere historic nostalgia. The liberal theory of civil society as part of economic theory has its roots in the works of *Adam Smith*. Time and time again, the «invisible hand» is misconstrued as a dogmatic belief in a pre-existent harmony merely serving to stabilize the current conditions. Just as *Marx's* visionary view of a society without division of labour ought not to prevent us from taking his critique of the capitalist system seriously, so an apparently metaphysical formula should not stop us from recognizing the political and sociological significance of the first political theory of a society marked by the division of labour. It is this theory which forms one of the cornerstones of Marxian analysis and which underlies the contemporary policy on competition.

The task facing us today consists of developing a procedure which resolves disputes between free citizens pursuing their own interests at the place where they break out. The conflicts must be resolved on the basis of the rule of law. This is the traditional role of the rules of private law, while it is the province of the political constitution to address the problems which should not be left to the antagonisms of society. A free society cannot exist

without recognizing this tension between individual liberty and political rule. Liberty will be just as completely and irrevocably destroyed by assigning absolute power to the State or to society as it would be if the individual or the corporation were to be accorded absolute freedom. Those who view modern competition policy in this light – which is certainly more than a merely historic context – must face up to the criticism that corrective adjustments to the market economy or to «late capitalism» are neither feasible nor desirable. *Marx* considered constant crisis and final self-destruction as the price at which the capitalist system achieves the full development of productive forces. On the other hand, those modern critics eager to burden the system in order to test its capacity of survival assume a degree of natural stability which by far exceeds the optimism of the old liberals. Quite apart from the question of good faith in politics, however, a prior condition for rational argument is the need not to disregard the probable impact of policy measures on the functions of the system.

My paper is intended as a contribution to the ideas on how competition policy can protect a free market economy against the aberrations which it generates and thus to maintain the basic conditions in which free action by the individual remains compatible with public interest.

2. One of the most difficult assignments for a parliamentary democracy – and not only vis-à-vis the commercial enterprises – is that of steering social forces in such a manner as to ensure that no group reaches a position where it can substitute its own special interests for the interest of the society as a whole. One instrument for attaining this goal are the rules against the restriction of competition. The suggestion has been put forward that the principle of a separation of powers in the economy should be realized by applying the principle of countervailing powers. According to this theory, cartels are to be admitted and not to be prohibited. This proposal is then backed by reference to the principle of a bilateral monopoly on the labour market. However, such an argument fails to recognize the role played by an individual enterprise in a market economy as well as the principle of a separation of powers in society as one of the prerequisites for the possibility of a separation of powers in the State. The division of labour as the organizational principle behind decentralized economic planning by commercial enterprises represents the mainspring of deconcentration. The legally guaranteed freedom of planning for private undertakings presupposes the existence of a certain degree of self-regulation. Indeed, it would forfeit its lawful title if there were to be a move towards accepting the principle of the largest possible acquisition of power. Only a legitimation of sectional self-interests to accord with their social functions permits a separation of powers in the relationship between the State and society. That also holds good for the organization of employees' interests. An essential feature of the social balance maintained in our present State is that civic interests must not be reduced to mere employer or employee interests.

It is against this background of a functional differentiation of social interests that we must see the rules against restraints of competition. One of the decisions which determines the substance of competition policy is the extent to which certain degrees of market power are accepted as inevitable or beneficial. Behind all modern cartel law stands the realization that cartels do not evolve in order to counter already existing market power and that cartels, once they have been organized on both sides of the market, do not neutralize each other. Clearly, no cartel or market-dominating enterprise is able to achieve an absolutely secure market position. In truth, it may be said of anyone's market position that it remains subject to a certain degree of competition either from the development of substitute products, the penetration of regionally protected markets by foreign competitors or the oft-quoted general competition among enterprises for the purchasing power of consumers. For this reason, a policy which protects not so much the competition encountered by firms in the markets as the competition which may persist inspite of the admission of a cartel triggers a mechanism serving to legitimize further restrictive practices. Any restraint of competition is immaterial in comparison with the next higher stage of feasible market power. The

admissibility of evidence envisaged in the Government's draft of a second amending bill to the Act against Restraints of Competition that those cartels are valid which impair competition to an immaterial degree only is no bagatelle. On the contrary, the proposal would lead via «group competition» and countervailing powers to coalitions set up at the expense of third parties. Hence, a general prohibition of cartels and an effective merger control constitute the foundations of every sound competition policy.

The feasibility of such a policy is denied because of the structure of modern industrial societies. Government planning, the international character of competition and the conflicts caused by the differences between private and public scarcities (environmental protection) – all these arguments are advanced to attack allegedly outmoded views on competition. It may be added at this stage that environmental protection based on the principle that «the pollutor must pay» is perfectly compatible with the market-economy system. It is the task of the legislator to determine the appropriate data on which entrepreneurs can base their plans. But among the central issues of competition policy are its relation with overall economic planning and the international character of markets and enterprises.

3. *Galbraith* used the planning system and the «technostructure» to justify his thesis that competition policy had become superfluous in an industrial society. At best, it represented a harmless fiction which could be retained until its insignificance became clear to all. *Galbraith* saw the goals of Government's economic policy as being identical with the motives and aims of the large oligopolistic corporations. Moreover, these firms possessed the power to realize their aims autonomously: the achievement of stable prices by an oligopolistic market strategy; the creation of the requisite demand through advertising; economic growth through a technical progress, which had become independent of all other objectives. The prospect derived from this interpretation of the industrial state is an approximation of the East and West systems. The political conclusion is the call to intellectuals in Western states to attack the alliance between industry and government in order to guarantee the implementation of the requisite measures for environmental protection. In all other respects, *Galbraith* assumes that the governmental and business interests are merged in the planning system. He reiterates the errors of a psychology-oriented economic science, which he seeks to refute, by pointing out that the motive of profit maximization no longer furnishes an adequate explanation for the acts of the «technostructure». This may be illustrated by an example of eminent importance for competition policy. In the conditions prevailing under oligopolistic competition, corporations undoubtedly enjoy a substantial degree of autonomy in setting their prices. Since the Thirties, economists have worried about the effects of these «administered prices». Depending on what assumptions one proceeds from, the outcome may be the most contradictory policy recommendations. Proposals range from the permission of cartels in order to prevent ruinous competition to a universal prohibition of cartels in order to prevent the collusive elimination of price competition to government controls on prices and investment. *Galbraith*, however, expects that entrepreneurs' price policies will fall into line with the Government's aims of overall economic planning. As both the theory and practice of oligopolistic markets have shown, the autonomy in the setting of prices may be used and has in fact been used in order to pursue an anti-cyclical policy. American researchers have established that downward price flexibility during a cyclical downswing is comparatively less severe in industries with a high degree of concentration. The recessions occurring after World War II were even characterized by a situation in which the prices rose in the most concentrated industries whilst employment and utilization capacity fell. In other words: Governmental conjunctural policies become all the more difficult, the greater the autonomy of corporations and their price policies is i. e. the greater the restraint of competition and the degree of concentration. Consequently, a policy of maintaining competition improves the effectiveness of the instruments of conjunctural policy.

Ironically, the adherents of the theory that virtually all economic problems can be resolved by controlling demand through monetary policies have now reached an impasse

because of the oligopolistic market structures. To the possibilities of frustrating governmental policy by corporate administration of prices must be added the possibilities of evading the measures of overall economic planning by switching to international markets. Furthermore, transnational corporations are now in a position to choose between different economic policies which best correspond with their own objectives. In such circumstances, anyone who criticizes the «concerted action» in West Germany as concerted *laissez-faire* is failing to appreciate that this situation cannot be attributed to the State's lack of willingness to introduce controls on prices, investment and wages. The cause is, rather, the rational reaction of transnational enterprises to national policies which have created throughout the world the very conditions whereby these corporations can profit from the adaptation to divergent and antagonistic economic and monetary policies.

4. Transnational corporations have become the symbol of the internationality of business organizations, markets and competition. The conclusion often drawn by the critics of competition policy is that there would now appear to be little point in operating a national competition policy and more particularly a national merger control in a world characterized by keen international competition. The usual argument in West Germany is to emphasize the integration of markets in the European Common Market and the priority of the EEC's competition policy. No doubt, it will in the final analysis hinge on the growth of European integration and on the development of the EEC's competition policy as to whether the internationality of economic relationships can be matched by the internationality of legal and political institutions. But this does not imply that the maintenance of viable competition must be left to the EEC. The thesis of the end of national competition policies misjudges the political character of the EEC and the bounds of cooperation between its Member States. As a glance at a federal Union like the USA will reveal, the Federal Antitrust Laws do not preempt the State Antitrust Laws; nor are the latter rendered irrelevant as a matter of practical significance. As regards EEC policy on competition, this cannot become any better or more efficacious in the long run than the policy practised in each individual Member State. But the essential consideration remains this: the present trend of industrial concentration within the EEC confirms the need for an effective national merger control. Despite the lack of reliable quantitative data, it is possible to pinpoint the following movements:

- the concentration of business enterprises largely takes place between firms from the same Member State with a resultant formation of small oligopolistic groups;
- the public sectors in Member States are developing exclusively on a national footing;
- transnational groupings in the Common Market more often involve third-state corporations (especially from the USA) than corporations from member countries.

That national business concentration in the Common Market does not automatically ensue from an imperfect form of economic integration may be seen from the rapid penetration accomplished by American enterprises. There is much evidence to show that the policy of a territorial division of markets and refraining from interference in the internal affairs of other national industries has survived as one of the maxims inspiring European business policy. If present appearances are not deceptive, then the absence of an effective national competition policy would take us closer to a system of the separation of national markets. International competition will serve as a justification of restraints of competition on the home markets whilst international competition is being suppressed by cartels. Such a development would be as incompatible with the aims of the Treaty of Rome as it is with the requirements of a national economic policy. One of the objectives of the Treaty of Rome is the prevention of national blocs and monopolies, to facilitate the division of labour in a greater market and to guarantee a system of undistorted competition. However, this does not mean that the responsibility of individual governments for the public weal does not extend to competitive conditions on the respective national markets. For a long time to

come, the political process will legitimize governmental powers primarily at member-state rather than at European level. With this in mind, the social and economic prerequisites governing the workability of such a process must also be assured at national level.

The opportunities available under a European competition policy may well be forfeited by the current standstill on integration and the crisis facing EEC institutions. The Commission is already attempting to overcome the EEC's lack of political capacity to act by enlisting commercial enterprises for political purposes. What *Galbraith* referred to as the inevitable fate of industrialized society is now becoming a political goal in the Commissions's programme on EEC industrial policy. The commission sees one of the Community's functions as promoting European-controlled multinational enterprises, the «transnational European undertakings», with the aim of expanding key industries. The Commission is actuated in this policy by political considerations. As it pointed out in a memorandum to the Council of Ministers on 18 March 1970, the term «transnational European corporations» should imply not only those firms which carry on activities in several countries, but also those whose capital and management come from several countries and whose centre of decision-making lies in Europe. The goal must consist in permitting and even in facilitating the existence of enterprises which do not necessarily or exclusively derive their capital and personnel from the six Member States, but which must be in a position to compete in Europe and on the world market with the giants from overseas.

A competition policy designed to disperse and control the economic power of business firms and an industrial policy desirous of enlisting individual enterprises and groups of enterprises for reasons of both foreign and economic policy are certain to clash in the course of time. One surprising point is the virtual complete absence of any political reaction to the Commission's proposals. One need only recall the impassioned debates aroused by the Commission's early suggestions on medium-term economic policy. But it is only industrial policy which involves the attempt – an attempt unjustifiably expected to flow from medium-term economic policy – to transcend the limits of globally effective instruments of economic policy by enlisting firms and their central associations to achieve political goals. This is not the place for talking about the political and institutional preconditions to be fulfilled before any effective political control can be exercised over corporations of this magnitude. But there can be no doubt that the EEC still does not dispose of such political power. Whether or not the EEC ought to acquire it in the future will depend in no small measure on the envisaged social goals. If the real task for competition consists in strengthening the capacity of the economic system without creating a closed shop for large established corporations and in guaranteeing by means of a neutralization of economic power the conditions in which basically independent political decision-making is possible, then the industrial policy proposed by the Commission cannot be the goal to which Europe aspires.

Instead of harnessing industrial concentration to pursue a policy of balance vis-à-vis the USA, the prerequisites ought to be created for an effective international competition policy. Some form of coordination will in any case be indispensable because of the extraterritorial impact of European law, American law and other national laws. The enlarged EEC has created improved preconditions for this.

5. A study of German competition policy against this background reveals that the political debate has reverted after nearly 15 years of practical experience to its original point of departure: the contrast between the principle of prohibition of cartels and the principle of abuse control. Today, cartels are labelled cooperation. The most significant political development is the progress being made towards the abandonment of the ban on cartels. The formal content of Article 1 of the Act against Restraints of Competition is now being put under a taboo. Inasmuch as case law actually translates the prohibition into reality, this trend should be rectified by the legislature. Where case law results in the virtual inefficacy of this provision, it is to be preserved as part of its indispensable substance. The exceptions to the prohibition of cartels are treated as vested rights which ought to be extended and certainly

not restricted. The most important issues inherent in the privileged position of banking, insurance, transport, energy and agriculture are hardly discussed today. By contrast, the concessions granted by the law-makers on the path leading to the general authorization of cartels are attacked as being inconsistent half-measures, because they do not eliminate the remaining «discrimination» against industry.

A formalist interpretation of the ban on cartels such as the Federal Ministry of Economics endorsed in its «cooperation manual» wants to take into consideration only the literal content of contracts as distinguished from their actual impact on competition. Probably the most significant effect of this interpretation of the Law is the definition of the dividing line between cartels and mergers in terms of their legal form. Article 1 of the Act against Restraints of Competition is held to be inapplicable as long as the immediate object of a joint venture is a specific entrepreneurial function. On the other hand, a restraint on competition effected by the joint venture among its members is said to be legally irrelevant. Here, the objection is that a restraint implicit in a contractual obligation does not take into account its real impact upon the market and should therefore be disregarded. But this impact, it appears, should only become of relevance if it serves to show that no substantial impairment of competition within the meaning of the Act can be proven. The same argument represents the rationale for the amendment of § 1, which was to legalize all cartels of minor importance. Because of the widespread public criticism, the government then proposed a new exception for cartels which promote rationalization and do not curtail competition to any appreciable extent.

The public discussion neglected another equally important revision of Article 28 of the Act against Restraints of Competition, i. e. the legalization of contractual competition rules «for the purpose of counteracting conduct which violates the principles of fair competition or the functioning of effective competition and of encouraging conduct which is in line with these principles». The amendment is intended to overrule the Federal Supreme Court's decision under which the original Article 28 does not justify competition rules for the purpose of protecting or maintaining specific market structures. The surprising official explanation adduced for the amendment of Article 28 alleges that restraints of competition in competition rules are likely to realize the aims of a statutory prohibition of monopolization and abuse of market dominating positions. However important it may be to develop rules governing the conduct of market-dominating enterprises, the agreements to which these firms accede are hardly an appropriate way of achieving such results. Furthermore, the amended Article 28 would have the effect of withdrawing enterprises from the augmented abuse control for market dominating enterprises, which in turn is cited as a reason for relaxing the prohibition of cartels. The amendment of Article 28 aims at giving enterprises the right to decide in their agreements which structural changes, investments, concentrations and marketing channels they deem compatible with «fair and effective competition». This brings us back to the traditional argument that cartels protect enterprises from ruinous competition and promote orderly marketing in the joint interest of all concerned.

6. Substantial difficulties in the dispute about the aims of competition policy in general and the effectiveness of abuse controls in particular arise from the fact that market structure, market behaviour and market performance are interdependent. For this reason, any one of these criteria may be used without necessarily involving contradictory policy aims. One may prohibit certain market structures, e. g. through merger control, to bring about a certain market conduct. One can try to judge market conduct in terms of performance to be expected of a given market structure, as the proponents of the theory of «as-if competition» do. One can prohibit certain conduct, e. g. price discrimination, in order to prevent a further restraint of competition and, at the same time, a change in market structure. In the final analysis, every competition policy will consist of a blend of these elements. In order to prevent the deterioration of competition policy into a cloak for dirigistic intervention, priority should be given to the preservation of market structures compatible with effective

competition. Anticompetitive practices should be prohibited by rules which do not interfere with the effectiveness of competition. The abuse control by the cartel authority on the basis of market performance should be treated as what it always will be in the final instance: a somewhat ineffective expedient to be employed when the other instruments of competition policy have failed. The current competition policy as formulated in the second amending bill to the Act against Restraints of Competition points in the opposite direction. It favours cartels and adopts abuse control as a basic instrument of competition policy. The proposed merger control provisions are not sufficient to change the trend to further concentration through acquisitions of shares or assets.

7. The expectation that the exclusion of abuse control would gain the approbation of the Federation of German Industry, which advocated the abuse principle for cartels, has proved to be wrong. Section 22 of the Act against Restraints of Competition authorizes the cartel authority to prohibit abusive practices by market-dominating enterprises or groups of enterprises. The provision has proved ineffective. Under the proposed amendments, the definition of market domination is to include a «paramount market position» in relation to competitors. The most important determinant of such a position, besides the share of the market, is the financial strength of the enterprise. The harsh criticism of this proposal fails to take into account the inseparable link between the relaxing of the prohibition of cartels, a control of mergers between the largest firms only and the remaining functions of abuse control. Abuse control is a viable alternative to the prohibition of cartels and an effective merger control only if criteria are available in order to prevent monopolistic conduct by market-dominating enterprises or groups of enterprises. Proponents of the abuse principle must answer this question unless they feel sure that political influence and practical unfeasibility will in any case lead to the inefficacy of abuse control. The limits to effective supervision of market-dominating enterprises may be illustrated by a marginal case which has been extensively discussed in legal and economic writings. Let us assume that the cartel authority were to be instructed – as has often been demanded – to oblige a market-dominating enterprise to behave as if competition existed. I shall leave aside the theoretical and the even greater practical misgivings about the feasibility of such a criterion. Let us further assume that the cartel authority ascertained (by virtue of the price policy and costs of a hypothetical representative firm) the price policy which the market-dominating firm would find possible to operate in conditions of effective competition. Any supervision of this kind leads necessarily to the direct control of prices, production and investment policy. The problem is clearly set out in Article 3 of the ECSC Treaty. This provision obliges the institutions of the Community to ensure the establishment of the lowest prices under such conditions that these prices do not result in higher prices charged by the same undertakings in other transactions or in a higher general price-level at another time while allowing necessary amortization and normal return on invested capital. Such limits to price controls, which are also known from the supervision of regulated industries in the USA, are necessary in order to avoid expropriation. An application of these principles of abuse control to price-setting by cartels implies the selection of a representative, low-cost enterprise. Cartel members which are «non-representative» firms could thus be forced into bankruptcy by administrative price controls. The political and practical feasibility of such a policy almost disproves itself. Within the framework of cartel supervision, the limit to confiscatory price controls (which can only be ascertained in terms of assets and costs of a single firm) would mean that not the costs of an efficient and representative enterprise but those of the least efficient enterprise would have to be taken into consideration if one assumed that the cartel continued to exist.

Abuse control based on market performance frequently means only that market-dominating enterprises must prove to the satisfaction of the cartel authority that certain measures of their business policy are not arbitrary. A good illustration is the action by the Federal Cartel Authority against price-rises for petrol in connection with the Suez crisis. Abuse control can

surely not resolve the conflict between private interests in restraints of competition on the one hand and the public interest in maintaining competition on the other.

8. The traditional distinction drawn between cartels and industrial concentration has lost all connection with reality. The basis of this distinction is the contrast of the coordination of competitive conduct by cartels to mergers and similar acquisitions which always involve a change in ownership. Because all measures of industrial concentration are investment decisions, they are related to the capital market, particularly to the market for controlling interests in corporations. However, such an approach confirms that the fundamentally different legal treatment of cartels and concentration has become obsolete. The ownership of an enterprise is normally the ownership of juristic persons. In principle, enterprises may use a juristic person in the same way as a planning instrument as they use contracts. And all the functions which private law recognizes in the natural person may be put into individual and isolated use by a juristic person. For that reason, it is impossible to generalise the purpose or economic effect of changes of ownership in corporations by looking at the legal nature of the transaction or at the connection in law between a juristic person and the individual rights of its members. We should bear in mind the devices like the holding company or cross-ownership of shares, which make possible corporate control with a minimum of investment.

An important and rather new development is the rapid penetration by joint ventures of oligopolistic markets. This development points to fundamental changes in the instruments for market strategy. The significance in practice of joint ventures exceeds by far all other types of corporate concentration. According to my researches, the hundred largest corporations in West Germany have entered into about a hundred control contracts with other firms, but they also participate in the over two hundred and fifty joint ventures which exist among them. The higher the degree of industrial concentration in an economy, the greater the significance of an integration between firms which serves to delimit – in the characteristic fashion of joint ventures – the zones of influence without any fresh investment or reorganization of the participating enterprises. The difficulties caused by joint ventures in corporation law, tax law and cartel law show how far the law has lagged behind the modern techniques of entrepreneurial organization. It is argued that joint ventures are not a merger because the founding corporations remain independent economic entities; and that they are not a cartel since the joint venture acts autonomously. This argument has been adduced to back a demand for exempting joint ventures as such from the provisions on merger control. The truth does not stand somewhere in the middle, it consists in the fact that a joint venture can be used as a cartel: it can bring about a merger or it can organize permissible forms of cooperation. Without examining each individual case on its merits, it cannot be ascertained what type of organization it represents. Similar to joint ventures, nearly all kinds of corporate concentration can be used to delimit zones of influence and control without the capital market exercising any remedial influence on these decisions.

The above-mentioned types of restraint on competition are not covered by the existing prohibition of cartels and they would be covered by the proposed control of mergers only if the participating enterprises had a minimum annual turnover of 1 thousand million DM. In cases where an arrangement because of its legal nature must be treated as a merger, although it is in fact a cartel, the amendment opens new ways to uncontrolled restraints of competition. However, the legislation should not reward the semantic skill of lawyers. The dividing line between cartels and mergers should be based upon the functional significance of the restraint of competition rather than on the legal nature of the transaction.

Another side-effect of merger control must not be neglected. The growth of corporations by merger accepted by the law often serves as a target for other enterprises. All kinds of concentration and integration are infectious if they change competitive conditions substantially. This effect on the process of concentration lies at the heart of the often misinterpreted judicial ruling in the USA, prohibiting mergers «where the effect may be to substantially lessen competition». Any legislation which controls mergers and forgoes the deconcentra-

tion of already existing market-dominating positions is bound to rely on the probable impact of mergers on the market and on concentration. In controlling mergers, the law should take into account the likelihood that an individual merger will

- substantially curtail competition;
- favour the emergence or strengthening of market-dominating enterprises;
- impair the continued existence or development of commercially independent firms; or
- enable the participating enterprises to evade the rule of conduct of the Act against Restraints of Competition.

It would be wrong and perilous to awaken the impression that competition policy alone is in a position to resolve the problems delineated above. But we can tell one thing from the competition policy pursued by a government, i. e. whether it relies in fact on the much cited desiderata of individual freedom, power of imagination and individual inventiveness as the fountain-head of social productivity.

Section II

The Functions of the State

a. The Framework of the Economic System

Prosperity Requires both Security and Freedom

Jean Baptiste Say

1803

Why should one prescribe to a producer that he should manufacture his goods in a certain fashion and no other? Perhaps because he will then best be able to market them? But, after all, who is more interested in selling the goods than he himself?

Where, however, ordinances serve to prevent fraud and to counteract cunning designed to malign other products or impair public safety, then they deserve our commendation. A manufacturer must not praise his goods on handbills for more than they really are. His honesty concerns the domestic consumer to whom the State must afford its protection, and it concerns foreigners since they will refuse to purchase merchandise from a nation which dupes him.

In this case, the manufacturer's private interests do not provide enough security against possible deception. He might, for example, just be about to sell his factory and wish to make a large profit at the expense of breaking faith. In other words, he might be prepared to sacrifice without misgivings a future which he no longer needs for the advantages of his present enjoyments. This is what has been happening since 1785 to French cloth in the Levant, where it is now completely without reputation and has lost its share of the market to German and English textiles. Even the very mention of the name of the cloth or the place of its provenance suffices to lead to a certain accepted presumption about its quality. Long experience has taught us that textiles which originate in a certain place have a definite width, that yarns have a certain number of threads and so forth. If one were to set up a workshop in the same town and make a cloth with the same name and label but differing from the customary standard, that would be tantamount to putting a false label on the article.

I think that these observations are adequate to indicate how far the Government's interference can go in order to keep within the proper limits. The Government must demand that the label states the truth, but in other respects it need not bother about anything. Even though this intervention by the authorities may prove to be useful, it nevertheless remains an evil. It is an evil, firstly because it causes a great deal of disquiet and paperwork for the

manufacturers and, secondly, because it always costs something. It may be that such costs are borne by the nation, as for instance when the government carries out these activities for nothing; on the other hand, the Treasury must pay the salaries of the officials. Equally, the costs may be borne by the consumers – as happens when a levy is imposed upon the merchandise. The effect of such a levy is to make the goods dearer. The increase in price constitutes a burden for domestic consumers and a good reason for foreign consumers to quit our market.

Hence, if government intervention is always an evil, a good government will always attempt to avoid it whenever it can. It will never assume a warranty for the quality of such goods with which the consumer cannot be so easily duped as the government itself. Moreover, it will never assume a warranty for goods whose properties cannot be attested by the officials. For a government must unfortunately reckon with negligent, inefficient and corrupt officials. But in the case of gold and silver, for instance, it must carry out a public test. The content of these metals cannot be scrutinized except by means of a complex chemical process, which only a few consumers can implement and which, even if they do, will cost them considerably more than they need to pay the State for this.

Even in the freest of nations, the public authorities have been able to intervene in the private sphere in certain cases without thereby harming production. For example, they have not the right to punish negligence as long as this is only detrimental to those who are themselves to blame. But if such negligence leads to damage for others, then the authorities must counteract it. Hence, the ordinance that trees must be cleared of caterpillars at certain times and that certain deleterious plants must be eradicated if their seeds can easily blow into others fields is both a fair and a wise provision.

In the former canton of Bern, an order was once given that every proprietor had to hand in to the authorities a certain number of cockchafers depending on the size of his estate whenever it was the time of year of these insects. The rich people of the canton then proceeded to purchase the stipulated quantity from the poor people, who thus made a business out of catching them. They carried out this activity so successfully that they liberated the country completely of these pests. It is specifically in the free countries that one finds these ordinances most frequently. Property enjoys such high esteem that the protection afforded to it is directed not only against attacks by malevolent persons, but also against the negligence of the careless. The only precaution to be taken consists in ensuring – as with all laws to promote public safety – that they impose as few constraints upon freedom as possible. The administrators must be skilful enough to ease the burden of such provisions. Vessels coming from the Levant, for example, have to submit to quarantine. Nothing could be more reasonable than that. Yet why do we also subject such ships to quarantine as merely arrive and then quickly depart? It would suffice perfectly if one were simply to place the goods which they bring in quarantine. This superfluous formality clearly damages our trade with the Levant.

The fact that such wise restrictions also cause complaints is no reason for blaming them out of hand and I have therefore not cited their disadvantageous aspects. Every absolute system has certain exaggerated features and every exaggeration is an evil. I have merely wished to draw appropriate attention to both the good as well as the bad sides of these ordinances so that one does not thoughtlessly give credence to counsels which only have one good side or reject measures without further ado because they engender certain disadvantageous consequences.

[. . .] It is not my task here to examine the reasons why public ordinances are being observed so imperfectly. I would merely add in passing that an order is never so well obeyed as when the person expected to execute it has an interest in so doing . . .

We have seen how little a Government can promote production by prohibitions, enforcements, privileges and premiums; in other words by these interventions the Government impairs precisely that production which it wants to promote. We have also seen that

when a government itself wishes to produce something, it usually destroys more than it brings into existence.

Actuated by all these considerations, some writers have asserted with reference to production and the augmentation of national wealth that Governments always do enough good if they merely do nothing wrong. But I feel that this signifies turning a blind eye to considerations which are no less necessary.

It is primarily the safety of people and property which most Governments wish to protect and which proves more beneficial to general welfare than all barriers hitherto erected. Barriers to economic efficiency merely curb the mainsprings of production, whereas a lack of safety tears them down. One need only look at Africa or Arabia, Persia and that Asia Minor, which was once full of flourishing cities; as *Montesquieu* said, their traces can still be found only in *Strabo's* descriptions. Now they stand prey to robbers and Pashas: their great wealth and their teeming millions have gone. The few people who have remained languish in misery and suffer all kinds of deprivation. But compare all this with Western Europe! However remote Europe may be from the peak of happiness which it might have reached, most States here have nevertheless now attained great prosperity. Although their peoples may be dispirited by the large number of restrictive laws and injunctions, they are rendered happy by the knowledge that usually everyone is safeguarded against personal insults and arbitrary deprivations.

Admittedly, it is much better if safety has been complemented by freedom. That well-travelled man, *Poivre*, once declared that he had never seen truly happy countries other than those which linked security and freedom. For all that, it still remains an advantage if we can obtain at least one of these two attributes even though we may have to sacrifice part of the other. A Government still deserves gratitude if it affords protection to our body even if it binds some of our limbs. True, it does not suffice when a Government protects us against the attacks of highwaymen; a good Government must also protect its people against the many terrible depredations of those people who have acquired great power through their rank and fortune; it must protect upright men against the chicanery of the judicial officers; and it must force everyone to fulfil the commitments which he has undertaken. When *Adam Smith* set about listing the true causes of Great Britain's attainment of happiness, he placed in first position that prompt and impartial administration of justice which forces the most powerful in the land to hold sacred the right of the lowest; which assures everyone of the fruits of this work and thus becomes the most powerful spur for every kind of industrial diligence.

It would be a meagre conclusion simply to point out that a new product merely displaces an old one and that new acquisitions merely encourage man's fickleness, since a plot of land can only produce a certain volume of crops. In the first place, if it were true that every new product displaces an old one, then the new one would not be brought into use if it did not confer an advantage compared with the old one. The old Gauls used to eat acorns; but is not the wheat which now grows instead of acorns and which provides a far healthier, more agreeable and richer nourishment a better thing? Have we not gained a great deal through this exchange? Secondly, it is already an advantage that one can cultivate two products instead of one and that one can alternate them – depending on differences in taste, in circumstances and in soil. Who knows whether perhaps those stretches of land which now lie fallow and bear nothing will in future yield new abundance? A temperature which is not beneficial for our customary products may perhaps prove to be salubrious for fruits which we do not yet have; every product which one gets to know contains some unknown qualities through which one can procure a fresh enjoyment or remedy an old inconvenience.

Competition and Economic Constitution

Leonhard Miksch

1937

For decades, economic debate has been dominated by the rivalry between the doctrines of a free economy and a planned economy. The meaning of these two terms has become so imprecise in the course of time that it is no longer uncommon to find them being used side by side. The expression «planned economy» connotes a whole range of ideas stretching from justifiable state regulation or the direst type of interest-group monopolism to the Utopian concept of the central direction of the entire economic process. The term «free economy» usually signifies an economy left to its own devices and as independent as possible of the State. An example of this would be an economy in which the State does not put any obstacles in the path of monopolist tendencies. With this background in mind, a private monopolism could thus designate its measures as liberal or socialist – depending on the given political circumstances. By contrast, classical economic liberals (who regarded the competitive system as the natural scheme of things) took the view that freedom from state interference would normally confirm the importance of the individual in keeping with the spirit of this system. In the meantime, the expression «economic freedom» has undergone a change in meaning, whilst our knowledge of competition has grown. Hence, there is no longer any justification for identifying a free economy with a competitive economy. It is only the dazzling concept of freedom – an expression devoid of any real meaning unless qualified – which continues to form a link between the two terms. This distracts attention from the main issue. In consequence, errors and misunderstandings become a major economic factor, whose impact can hardly be stressed sufficiently enough. If we are to pave the way leading to a fruitful policy of competition, then these mistakes must be rectified by tracing their historic roots in the 19th century.

Several of *Adam Smith's* observations point to his awareness of the State's role in the legal system. The fact that he paid a relatively small amount of attention to the State's role in economic policy sprang from several circumstances peculiar to the age in which he lived. He opposed the mercantilism of the previous epoch, but overestimated by far the harmony

peculiar to a self-regulating economy. The equating of a free economy with free competition may be chiefly explained by reference to this concept of inherent harmony. To this must be added the fact that *Smith* followed all his contemporaries of the 18th century in accepting the views of the Age of Enlightenment on nature. He thus viewed the State as deriving from the individual: for him, economic freedom flowed from the non-State sphere and represented the natural order of things. Today, opinions have changed. The State's policy on competition, whose significance was not recognized by the classical writers or else not sufficiently, has now come to the fore and the «natural order of things» has become a matter for the State. This shift in viewpoint has assumed extreme importance for the status of competition in our overall economic and social system. By the same token, however, it need not necessarily denote a great deal for the concrete organization of the market. For it does not make much difference in practice whether we call upon the State to restrict an individual's freedom of movement as much as necessary or whether we expect it to confer as much freedom as seems expedient. As for the harmony of free competition, the economic experts soon demonstrated that this is by no means complete.

The most remarkable occurrence was the failure to carry out the requisite corrective adjustments. In fact, the concept of a harmonious system became the battle-cry of a dying and perfunctory liberalism. People began to forget that a free economy can only be an economy organized by the State in conformity with free principles and, in consequence, they deprived the term «economic freedom» of its positive substance. What survived was the negative side: a repugnance to official actions. This fatal development would not have been possible if the false position adopted by economic liberalism had not been reinforced by ideas of quite a different kind. In the meantime, the protagonists of cultural advance in the world and in Germany in particular had turned to history for inspiration. Historicism formulated laws of historic development. Belief in the indestructible harmony of an economy free from State interference was gradually replaced by belief in a continuous evolution towards some form of planned economy. The concept of a regulative system, fundamental to any efficient economic laws, had to be modified, as human will-power and human rationality were both dethroned to make way for automatically operating laws of development. As a result, historicism joined hands in singular fashion with the empty shell of economic liberalism. Both these currents of thought flowed in the direction of *laissez-faire*. The notion began to hold sway that the State must leave it to a «free economy» to find its most convenient vehicle in accordance with the ordinances of history. The generic idea of «economic freedom» was turned upside down and it became a battle-cry to use against the State. The latter forfeited all claim to be the regulative force: it merely intervened in haphazard fashion to satisfy the wishes of the participants and thus became a party to anonymous economic forces. The supporters of a planned economy often found themselves in the same boat. They mostly only differed from the liberals of similar stamp by virtue of their opinion that the demolition of the competitive economy was not taking place fast enough.

In more recent times, the concept of a «planned economy» has taken on a somewhat different character. It is quite self-evident that the flow of goods and services in an economy may only be directed by the purchasing power available to consumers pursuant to a socially justifiable and acknowledged spread of income. After all, the sole function of trade and industry is to satisfy the needs of the consumer. Apart from large-scale catastrophes, there is only one event which can force economic policy to depart from this natural scheme of things and that is war. As the State appropriates everything in a modern war without being able for psychological reasons to abridge private incomes on the same scale, a war economy assumes the character of a struggle against the inherent and economically justifiable reactions of trade and industry. This struggle forms a characteristic feature of a war economy. It has to be ended and eliminated, together with the entire war economy itself, as quickly as possible. It is intolerable to think that sheer delight in these planning methods may encourage the

surreptitious smuggling of such interference and regulation methods into our future economic system. In an economy neither preparing nor conducting a war, there is absolutely no justification for economic authorities committed to fighting and repressing the economy and to preventing the consumer from purchasing whatever he wants, and is able to purchase.

The important thing is to rise above this confusion and to make a fresh approach. A free economy in the sense of a system in which the State has no role to play is neither desirable nor feasible. It would be better to refrain from using an expression like this because of its association with so many erroneous ideas. We know (or have rediscovered) that it is indisputably a matter for the State to organize the economy and to do so by establishing a uniform and uncontroversial economic structure. However, «organizing the economy» does not mean subjecting it to central direction and control. A decision freely taken by the persons engaged in the economic process in a spirit of self-responsibility forms the strongest source of inspiration and strength for progress. On the other hand, a central regulation of all economic processes is hardly feasible. That would impose an incredible burden of sterile and speculative activities upon the State. The complex train of events in the economy must be shaped in as free a fashion as possible. Organizing the economy implies organizing a free economy. This also accords with its true significance. It would be deplorable if one were to retain the custom of using the expression «market organization» to designate a condition which is nothing more than a regulation of the market undertaken by private participants. Regulation is an external process, organization an internal one. The regulation of a certain process means steering it from outside. On the other hand, the organization of this process signifies that one shapes the determining factors in such a manner as to enable it to proceed in the desired direction. Strictly speaking, only free competition deserves such an appellation. Where such competition is not possible, the State must intervene with some sort of regulation and this may only be designated as an order or system if it abides by principles which do not disarrange the unity of the economic structure. At any rate, we must not overlook the competitive principle as a primary regulative principle. The goal of economic competition lies in ensuring the greatest success for the best performance so as to encourage others to render their best performance. A harmonious interplay between the various elements making up the economy does not invariably ensue from competition, only when it takes place within certain rules. From this stems the demand to adapt competition to economic facts. The State can select one of three options in regard to competition:

1. Free competition. All those participating in the economic process may decide freely for themselves and they are bound solely by the general law on competition. This general law on competition forms the vehicle for the organizing of free competition.

2. Restricted competition. Freedom of decision for those taking part in the economic process is narrowed either by special provisions or by the supervision exercised by the State and its delegated authorities. The ad hoc provisions for certain markets and economic areas including government licences and administrative regulations make up the special laws on competition.

3. State Regulation. The State completely eliminates the freedom of those participating in the economic process to choose for themselves and directs the train of economic events itself.

[. . .] Only in those cases where a free exchange economy does not function adequately is a certain degree of government direction justifiable. As far as we can see today, there are three sectors which come into question in this context: monopoly controls, wages formation, credit and employment policy.

Like government direction of the economic process, the nationalization of the means of production forms a contrast to a consistent struggle against economic positions of power. A totalitarian state is conceivable without a national economy, but on the other hand a purely national economy is bound to result in a totalitarian state. The concept of placing commercial undertakings under public ownership has undergone some remarkable changes. After originating under the impact produced by the failure of the traditional approaches to the

achievement of harmony on the labour market and thus being directed against the fullness of power held by an employer vis-à-vis his employees, the idea of nationalization is now only encountered outside communist countries in monopolistic industries because quite different options have meanwhile been tried out in practice for balancing opposite interests on the labour market. As the experience of the last few decades has shown, the State can crush democratic freedoms much more effectively than any private individual – however much power the latter may have accumulated. Yet even these fall-back positions adopted by the champions of nationalization are untenable. For if nationalization is no longer regarded as a matter of principle but as a question of expediency, then one cannot help coming to the conclusion that it represents neither a particularly effective nor an appropriate means for suppressing economic power. Those entities which hold the real power remain intact in the event of nationalization. As we know from the past, public monopolies are more disquieting than private ones. They are politically dangerous because they promote State totalitarianism and economically harmful because the active exploitation of the market is replaced by the inertia of a bureaucratic apparatus. However reprehensible a monopoly's profit may be, it is always preferable in terms of the economy as a whole to an uneconomic rise in costs. Indeed, we must abandon the view that monopolies are only desired and maintained, because they permit the achievement of special gains. It is always more convenient to dominate a market than to face up to competition. Particularly in the case of public monopolies, convenience is very often an adequate motive for radical monopolistic measures. Moreover, we ought not to believe that economic power always resides in the proprietor himself. More often than not, it is exercised by the administration which commands the concentrated means of production.

But one point emerges quite clearly. If we were to leave all the private concentrations of power from the past as they now stand, then an attempt would certainly be made at a later stage to undermine and destroy the competitive system. To judge from earlier experiences, it is very doubtful whether a democratic State will prove to be capable in the long run of withstanding pressure and of applying with the absolute degree of indispensable strictness the competitive principles on which the whole system rests. Hence, there can be no doubt about the need to destroy these positions of power. But that in itself does not presuppose nationalization. It would suffice if the capital were to be widely dispersed among private owners and a new amalgamation of power prevented by introducing a maximum level for capital participation. At the same time, the concentrations of the means of production ought to be relaxed inasmuch as this can take place without impairing the efficiency of the German economy.

It should be noted in this context that the relationship between the State and the economy is quite different under state monopolistic supervision to that under a system of nationalized monopolies. Under nationalization, the power of the bureaucracy in trade and industry and in administration accumulates. Under monopoly supervision on the other hand, the supervisory authority and the supervised entrepreneurs are pulling in opposite directions.

After the abolition of controls, the next step for setting up a competitive system will be the creation of favourable conditions for perfect competition. Various ways and means have already been named for achieving this. They are as follows:

1. An Expansion of Markets by a Return to Free Trade. In future, Germany will not only be an industrial processing country but also an agricultural processing country (following the loss of the agricultural surplus regions in the East). In these circumstances, free trade is always an advantage even though other countries may adhere to protectionism. Basically, the protectionist influence exercised upon the production programme through differentiated tariffs as well as government controls within the country arose for military reasons. Thus, free trade flourishes best of all in peaceful conditions and it reflects one of the strongest manifestations of the will for peace of which a country is capable. A changeover to free trade would benefit both trade and production in Germany. On the one hand, it would create a

fairly favourable atmosphere. On the other hand, it is quite clear that only the utmost exploitation of all comparative advantages in costs will enable the German economy to remain at all viable in the next few years. The recent computation that in these circumstances Germany would have to import more foodstuffs for a modest standard of living than the total volume of goods of every kind in former times reveals what an expensive luxury agricultural protectionism for German really was.

2. Expansion of the Markets through Standardization. The standardizing of goods is a sound method of eliminating the numerous monopolies which exist in the field of quality, trade marks and «ideas». But since it can promote the growth of enterprises to an optimal size, standardization may also encourage concentration among firms. Nevertheless, the advantages probably exceed the disadvantages.

3. Strengthening the Marketing Position of Traders. By virtue of its very structure, trade is less apt to resort to economic concentration. In trade, cartels have only arisen where industry has forced or encouraged their establishment. One matter of particular importance would be to encourage the replacement of quality marks by proprietary articles. There should also be a general prohibition of resale price maintenance.

4. Amendment of the whole Field of economic Law with the Aim of eliminating all those Provisions which favour Concentration. This applies to tax legislation, patent law, company law, the law of contract and bankruptcy. In the field of company law, the restraints on liability ought to be substantially reduced. The institution of companies with limited liability should be completely abolished and joint-stock companies replaced by companies limited by shares, but having one or more general partners. Consideration should also be given to the determination of a certain percentage of shares which natural or juridical persons may hold in a limited company. Under the law of contract, the important thing is to create special provisions adapted to the individual markets in order to permit a prohibition of all private agreements on conditions and all non-official formal contracts.

As can be seen, there exists a need for a very active economic policy. That is what separates us from the economic liberalism of the 19th century: we have learnt to distinguish between laissez-faire and competition; we clearly want to establish an economic order; and we now think in terms of economic constitution.

Economic Policy and the Rule of Law

Friedrich A. von Hayek

1960

1. The classical argument for freedom in economic affairs rests on the tacit postulate that the rule of law should govern policy in this as in all other spheres. We cannot understand the nature of the opposition of men like Adam Smith or John Stuart Mill to government «intervention» unless we see it against this background. Their position was therefore often misunderstood by those who were not familiar with that basic conception; and confusion arose in England and America as soon as the conception of the rule of law ceased to be assumed by every reader. Freedom of economic activity had meant freedom under the law, not the absence of all government action. The «interference» or «intervention» of government which those writers opposed as a matter of principle therefore meant only the infringement of that private sphere which the general rules of law were intended to protect. They did not mean that government should never concern itself with any economic matters. But they did mean that there were certain kinds of governmental measures which should be precluded on principle and which could not be justified on any grounds of expediency.

To *Adam Smith* and his immediate successors, the enforcement of the ordinary rules of common law would certainly not have appeared as government interference; nor would they ordinarily have applied this term to an alteration of these rules or the passing of a new rule by the legislature so long as it was intended to apply equally to all people for an indefinite period of time. Though they perhaps never explicitly said so, interference meant to them the exercise of the coercive power of government which was not regular enforcement of the general law and which was designed to achieve some specific purpose. The important criterion was not the aim pursued, however, but the method employed. There is perhaps no aim which they would not have regarded as legitimate if it was clear that the people wanted it; but they excluded as generally inadmissible in a free society the method of specific orders and prohibitions. Only indirectly, by depriving government of some means by which alone it might be able to attain certain ends, may this principle deprive government of the power to pursue those ends.

The later economists bear a good share of the responsibility for the confusion on these matters. True, there are good reasons why all governmental concern with economic matters is suspect and why, in particular, there is a strong presumption against government's actively participating in economic efforts. But these arguments are quite different from the general argument for economic freedom. They rest on the fact that the great majority of government measures which have been advocated in this field are in fact inexpedient, either because they will fail or because their costs will outweigh the advantages. This means that, so long as they are compatible with the rule of law, they cannot be rejected out of hand as government intervention but must be examined in each instance from the viewpoint of expediency. The habitual appeal to the principle of non-interference in the fight against all ill-considered or harmful measures has had the effect of blurring the fundamental distinction between the kinds of measures which are, and those which are not, compatible with a free system. And the opponents of free enterprise have been only too ready to help this confusion by insisting that the desirability or undesirability of a particular measure could never be a matter of principle but is always one of expediency.

In other words, it is the character rather than the volume of government activity that is important. A functioning market economy presupposes certain activities on the part of the state; there are some other such activities by which its functioning will be assisted; and it can tolerate many more, provided that they are of the kind which are compatible with a functioning market. But there are those which run counter to the very principle on which a free system rests and which must therefore be altogether excluded if such a system is to work. In consequence, a government that is comparatively inactive but does the wrong things may do much more to cripple the forces of a market economy than one that is more concerned with economic affairs but confines itself to actions which assist the spontaneous forces of the economy.

It is the purpose of this chapter to show that the rule of law provides the criterion which enables us to distinguish between those measures which are and those which are not compatible with a free system. Those that are may be examined further on the grounds of expediency. Many such measures will, of course, still be undesirable or even harmful. But those that are not must be rejected even if they provide an effective, or perhaps the only effective, means to a desirable end. We shall see that the observation of the rule of law is a necessary, but not yet a sufficient, condition for the satisfactory working of a free economy. But the important point is that all coercive action of government must be unambiguously determined by a permanent legal framework which enables the individual to plan with a degree of confidence and which reduces human uncertainty as much as possible.

2. Let us consider, first, the distinction between the coercive measures of government and those pure service activities where coercion does not enter or does so only because of the need of financing them by taxation. In so far as the government merely undertakes to supply services which otherwise would not be supplied at all (usually because it is not possible to confine the benefits to those prepared to pay for them), the only question which arises is whether the benefits are worth the cost. Of course, if the government claimed for itself the exclusive right to provide particular services, they would cease to be strictly non-coercive. In general, a free society demands not only that the government have the monopoly of coercion but that it have the monopoly only of coercion and that in all other respects it operate on the same terms as everybody else.

A great many of the activities which governments have universally undertaken in this field and which fall within the limits described are those which facilitate the acquisition of reliable knowledge about facts of general significance. The most important function of this kind is the provision of a reliable and efficient monetary system. Others scarcely less important are the setting of standards of weights and measures; the providing of information gathered from surveying, land registration, statistics, etc.; and the support, if not also the organization, of some kind of education.

All these activities of government are part of its effort to provide a favorable framework for individual decisions; they supply means which individuals can use for their own purposes. Many other services of a more material kind fall into the same category. Though government must not use its power of coercion to reserve for itself activities which have nothing to do with the enforcement of the general rules of law, there is no violation of principle in its engaging in all sorts of activities on the same terms as the citizens. If in the majority of fields there is no good reason why it should do so, there are fields in which the desirability of government action can hardly be questioned.

To this latter group belong all those services which are clearly desirable but which will not be provided by competitive enterprise because it would be either impossible or difficult to charge the individual beneficiary for them. Such are most sanitary and health service, often the construction and maintenance of roads, and many of the amenities provided by municipalities for the inhabitants of cities. Included also are the activities which Adam Smith described as «those public works, which, though they may be in the highest degree advantageous to a great society, are, however, of such a nature that the profit could never repay the expense to any individual or small number of individuals.» And there are many other kinds of activity in which the government may legitimately wish to engage in order perhaps to maintain secrecy in military preparations or to encourage the advancement of knowledge in certain fields. But though government may at any moment be best qualified to take the lead in such fields, this provides no justification for assuming that this will always be so and therefore for giving it exclusive responsibility. In most instances, moreover, it is by no means necessary that government engage in the actual management of such activities; the services in question can generally be provided, and more effectively provided, by the government's assuming some or all of the financial responsibility but leaving the conduct of the affairs to independent and in some measure competitive agencies.

There is considerable justification for the distrust with which business looks on all state enterprise. There is great difficulty in ensuring that such enterprise will be conducted on the same terms as private enterprise; and it is only if this condition is satisfied that it is not objectionable in principle. So long as government uses any of its coercive powers, and particularly its power of taxation, in order to assist its enterprises, it can always turn their position into one of actual monopoly. To prevent this, it would be necessary that any special advantages, including subsidies, which government gives to its own enterprises in any field, should also be made available to competing private agencies. There is no need to emphasize that it would be exceedingly difficult for government to satisfy these conditions and that the general presumption against state enterprise is thereby considerably strengthened. But this does not mean that all state enterprise must be excluded from a free system. Certainly, it ought to be kept within narrow limits; it may become a real danger to liberty if too large a section of economic activity comes to be subject to the direct control of the state. But what is objectionable here is not state enterprise as such, but state monopoly.

3. Furthermore, a free system does not exclude on principle all those general regulations of economic activity which can be laid down in the form of general rules specifying conditions which everybody who engages in a certain activity must satisfy. They include, in particular, all regulations governing the techniques of production. We are not concerned here with the question of whether such regulations will be wise, which they probably will be only in exceptional cases. They will always limit the scope of experimentation and thereby obstruct what may be useful developments. They will normally raise the cost of production or, what amounts to the same thing, reduce over-all productivity. But if this effect on cost is fully taken into account and it is still thought worthwhile to incur the cost to achieve a given end, there is little more to be said about it. The economist will remain suspicious and hold that there is a strong presumption against such measures because their over-all cost is almost always underestimated and because one disadvantage in particular – namely, the prevention of new developments – can never be fully taken into account. But if, for instance, the

production and sale of phosphorus matches is generally prohibited for reasons of health or permitted only if certain precautions are taken, or if night work is generally prohibited, the appropriateness of such measures must be judged by comparing the over-all costs with the gain; it cannot be conclusively determined by appeal to a general principle. This is true of most of the wide field of regulations known as «factory legislation.»

It is often maintained today that these or similar tasks which are generally acknowledged to be proper functions of government could not be adequately performed if the administrative authorities were not given wide discretionary powers and all coercion were limited by the rule of law. There is little reason to fear this. If the law cannot always name the particular measures which the authorities may adopt in a particular situation, it can be so framed as to enable any impartial court to decide whether the measures adopted were necessary to achieve the general effect aimed at by the law. Though the variety of circumstances in which the authorities may have to act cannot be foreseen, the manner in which they will have to act, once a certain situation has arisen, can be made predictable to a high degree. The destroying of a farmer's cattle in order to stop the spreading of a contagious disease, the tearing-down of houses to prevent the spreading of a fire, the prohibition of an infected well, the requirement of protective measures in the transmission of high-tension electricity, and the enforcement of safety regulations in buildings undoubtedly demand that the authorities be given some discretion in applying general rules. But this need not be a discretion unlimited by general rules or of the kind which need to be exempt from judicial review.

We are so used to such measures being referred to as evidence of the necessity of conferring discretionary powers that it comes somewhat as a surprise that, as recently as thirty years ago, an eminent student of administrative law could still point out that «health and safety status are, generally speaking, by no means conspicuous for the use of discretionary power; on the contrary, in much of that legislation such powers are conspicuously absent. . . . Thus British factory legislation has found it possible to rely almost completely on general rules (though to a large extent framed by administrative regulation) . . . many building codes are framed with a minimum of administrative discretion, practically all regulations being limited to requirements capable of standardization . . . In all these cases, the consideration of flexibility yielded to the higher consideration of certainty of private right, without any apparent sacrifice of public interest.»

In all such instances, the decisions are derived from general rules and not from particular preferences which guide the government of the moment or from any opinion as to how particular people ought to be situated. The coercive powers of government still serve general and timeless purposes, not specific ends. It must not make any distinctions between different people. The discretion conferred on it is a limited discretion in that the agent is to apply the sense of a general rule. That this rule cannot be made completely unambiguous in its application is a consequence of human imperfection. The problem, nevertheless, is one of applying a rule, which is shown by the fact that an independent judge, who in no way represents the particular wishes or values of the government or of the majority of the moment, will be able to decide not only whether the authority had a right to act at all but also whether it was required by law to do exactly what it did.

The point at issue here has nothing to do with the question of whether the regulations justifying the actions of government are uniform for the whole country or whether they have been laid down by a democratically elected assembly. There is clearly a need for some regulations to be passed by local ordinances, and many of them, such as building codes, will necessarily be only in form and never in substance the product of majority decisions. The important question again concerns not the origin but the limits of the powers conferred. Regulations drawn up by the administrative authority itself but duly published in advance and strictly adhered to will be more in conformity with the rule of law than will vague discretionary powers conferred on the administrative organs by legislative action.

Though there have always been pleas on the ground of administrative convenience that

these strict limits should be relaxed – this is certainly not a necessary requirement for the achievement of the aims we have considered so far. It was only after the rule of law had been breached for other aims that its preservation no longer seemed to outweigh considerations of administrative efficiency.

4. We must now turn to the kinds of governmental measures which the rule of law excludes in principle because they cannot be achieved by merely enforcing general rules but, of necessity, involve arbitrary discrimination between persons. The most important among them are decisions as to who is to be allowed to provide different services or commodities, at what prices or in what quantities – in other words, measures designed to control the access to different trades and occupations, the terms of sale, and the amounts to be produced or sold.

So far as the entry into different occupations is concerned, our principle does not necessarily exclude the possible advisability in some instances of permitting it only to those who possess certain ascertainable qualifications. The restriction of coercion to the enforcement of general rules requires, however, that any one possessing these qualifications have an enforceable claim to such permission and that the grant of the permission depend only on his satisfying the conditions laid down as a general rule and not on any particular circumstances (such as «local need») which would have to be determined by the discretion of the licensing authority. Even the need for such controls could probably be rendered unnecessary in most instances by merely preventing people from pretending to qualifications which they do not possess, that is, by applying the general rules preventing fraud and deception. For this purpose, the protection of certain designations or titles expressing such qualifications might well be sufficient (it is by no means evident that even in the case of doctors this would not be preferable to the requirement of a licence to practice). But it is probably undeniable that in some instances, such as where the sale of poisons or firearms is involved, it is both desirable and unobjectionable that only persons satisfying certain intellectual and moral qualities should be allowed to practise such trades. So long as everybody possessing the necessary qualifications has the right to practise the occupations in question and, if necessary, can have his claim examined and enforced by an independent court, the basic principle is satisfied.

There are several reasons why all direct control of prices by government is irreconcilable with a functioning free system, whether the government actually fixes prices or merely lays down rules by which the permissible prices are to be determined. In the first place, it is impossible to fix prices according to long-term rules which will effectively guide production. Appropriate prices depend on circumstances which are constantly changing and must be continually adjusted to them. On the other hand, prices which are not fixed outright but determined by some rule (such as that they must be in a certain relation to cost) will not be the same for all sellers and, for this reason, will prevent the market from functioning. A still more important consideration is that, with prices different from those that would form on a free market, demand and supply will not be equal, and if the price control is to be effective, some method must be found for deciding who is to be allowed to buy or sell. This would necessarily be discretionary and must consist of ad hoc decisions that discriminate between persons on essentially arbitrary grounds. As experience has amply confirmed, price controls can be made effective only by quantitative controls, by decisions on the part of authority as to how much particular persons or firms are to be allowed to buy or sell. And the exercise of all controls of quantities must, of necessity, be discretionary, determined not by rule but by the judgment of authority concerning the relative importance of particular ends.

It is thus not because the economic interests with which such measures interfere are more important than others that price and quantity controls must be altogether excluded in a free system, but because this kind of controls cannot be exercised according to rule but must in their very nature be discretionary and arbitrary. To grant such powers to authority means in effect to give it power arbitrarily to determine what is to be produced, by whom, and for whom.

5. Strictly speaking, then, there are two reasons why all controls of prices and quantities

are incompatible with a free system: one is that all such controls must be arbitrary, and the other is that it is impossible to exercise them in such a manner as to allow the market to function adequately. A free system can adapt itself to almost any set of data, almost any general prohibition or regulation, so long as the adjusting mechanism itself is kept functioning. And it is mainly changes in prices that bring about the necessary adjustments. This means that, for it to function properly, it is not sufficient that the rules of law under which it operates be general rules, but their content must be such that the market will work tolerably well. The case for a free system is not that any system will work satisfactorily where coercion is confined by general rules, but that under it such rules can be given a form that will enable it to work. If there is to be an efficient adjustment of the different activities in the market, certain minimum requirements must be met; the more important of these are, as we have seen, the prevention of violence and fraud, the protection of property and the enforcement of contracts, and the recognition of equal rights of all individuals to produce in whatever quantities and sell at whatever prices they choose. Even when these basic conditions have been satisfied, the efficiency of the system will still depend on the particular content of the rules. But if they are not satisfied, government will have to achieve by direct orders what individual decisions guided by price movements aspire to.

Economic Order and Public Administration

Hans Willgerodt

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It can hardly be described as divulging a secret if one points to the impaired relationship which now exists between many liberals and the State and between them and the administrative authorities, too. The liberals like to underscore the opportunities open to every governmental organization to play the tyrant. They stress that the State naturally has to resort to its rightful jurisdiction as the supreme decision-making body in the land and to endow itself with the requisite instruments of power. Moreover, the liberals have voiced innumerable warnings about the abuse of power inherent in any expansion of government activities.

The liberals' main concern has usually been the need to protect individual freedom and private enterprise against such influences emanating from the State and its administrative bodies as may curtail freedom and paralyze market forces. The capacity of public administration for harming trade and industry as well as the economic system in general is a topic which frequently recurs in liberal literature. In order to obviate the ensuing disadvantages to individual freedom and private enterprise, the demand is made for a certain type of political constitution. Indeed, one of the standard titles to be found among liberal publications is «Economic Order and Political Constitution».

In more recent times, the liberals have also been borrowing an idea originally put forward already by *Adam Smith* and *John Stuart Mill* in their inquiry into whether the administrative authorities render in efficient and inexpensive fashion the public services desired by the citizens. In other words, the liberals have rediscovered the basic financial and fiscal problem which they lost sight of during a certain phase of their simplified theoretical studies. Nevertheless, their standpoint remains extremely critical. They emphasize unmistakably all the – undoubtedly existing – weaknesses of the state bureaucracy and make an attempt to attribute these weaknesses to the attitudes adopted by the civil servants. *Homo bureaucraticus* is assigned the same didactic functions in a kind of model analysis as *homo oeconomicus* in market analysis. The assumption is that a state functionary acts in his own

interest and does not differ in this respect from the private citizen. But whereas competition and the market ensure that, subject to certain conditions, an individual's pursuit of his personal interests does not infringe the interests of others but in fact harmonizes with them, the corresponding regulative systems in public administration are assumed to exist merely in imperfect form or not at all. A functionary is supposed to take a personal interest in the expansion of governmental activities over and above the level deemed to be beneficial by private citizens, because his salary and his influence depend on these activities. The public sector is considered inefficient, because it cannot go bankrupt. For reasons which are analysed in detail, the politicians' rivalry in the quest for votes is held to be an inadequate means to solve this problem. It is thus considered of prime importance to curtail the volume of state activity. In the second place, it is suggested to consider how public administration could be made to function more efficiently by constitutional reforms and perhaps also by introducing market-economy elements into this field. Without doubt, this discussion has inspired some remarkable standpoints and seriously embarrassed the academic proponents of the thesis that the State must always enjoy a steadily growing scope of action because of the «failure of the market». The communist view, also occasionally espoused by non-communists now, that capitalism only survives at the present time because the State has been stabilizing the economy in the service of the «monopolies» is an extremely naive theory, if only because of its underlying faulty assessment of the opportunities available to the State. The champions of these views seldom command enough administrative experience and even less frequently possess any sound knowledge of modern liberal theories on bureaucracy.

Nevertheless, the liberal critics of bureaucracy have adopted a somewhat simplistic view in more recent times by insisting that we should regard public officials as the villains of the piece just as *Karl Marx* used to assign this role to the capitalists. These critics may not think that functionaries are intrinsically inferior in character to the rest of us, but they do see them as doomed to develop anti-social characteristics under the modern system of government. *Adam Smith* was one of the first to point out that people not only choose goals which can be attained solely at the expense of others, but that they also attach importance to recognition by others. The same holds true in equal measure of functionaries and it would be illusory to impute an uninhibited egoism to persons who serve the State in this way. The many officials who today are still prepared to risk their health and their lives in the public interest furnish palpable evidence of the impropriety of such cynical simplifications. Furthermore, insufficient attention is paid to the fact that large private enterprises and central associations have bureaucracies which are by no means so efficiently curbed by competition and market forces that a strict dividing-line may be drawn between them and state bureaucracy when the relevant patterns of behaviour come to be evaluated.

The presently strongly emphasized view, however, that the behaviour of officials depends on the structure of public administration, the overall political set-up and the functions incumbent upon the bureaucracy, is quite correct. In this paper, I wish to consider how the civil service itself alters its character, its capacity and its internal organization once that a decision has been taken in favour of a certain economic system. In other words, the issue is no longer «economic order and the State constitution» but «economic order and public administration». The question is not what takes place for private individuals and commercial enterprises when the State permits, or aspires to, a certain economic system. The real issue consists in the consequences for the State itself and for its administrative apparatus if a certain economic policy is pursued. This viewpoint is unusual, even though the liberal classical writers in particular have always dealt thoroughly with this question.

It seems to be a contradiction that the exponents of political liberalism and the supporters of market-economy systems with their alleged enmity towards the State have played an outstanding role in shaping the modern State and its administration. It is certainly no great exaggeration to designate this State as a liberal invention. Naturally, however, such a statement elicits controversy. The emergence of a modern state bureaucracy is often credited

to the absolutist principalities and its preference for mercantilist economic policies. As regards the structure of the public authorities and their external criteria of organization, there is quite a lot to be said for this traditional line of thought. It was however only in the market economies of the 19th century that public administration developed those features which, according to *Max Weber*, are characteristic of a modern state bureaucracy: a system bound by laws and rules and therefore calculable for the citizens. Furthermore, it has limited jurisdiction and the officials in charge of a certain area of business must have the necessary specialized knowledge. An administrative authority is subject to certain defined controls. Above all, it cannot procure the funds it uses itself: it is allocated these funds and must account for their use. All operations and activities are carefully recorded in order to permit audits, to rule out misunderstandings and to preserve certainty of justice. Civil servants, whose qualifications are found out about in selection procedures, are rewarded thus that they can be expected to be immune to bribery.

At first sight, it would seem as if this set of characteristics cannot be related in any clear-cut way to the various economic systems. It can be argued for example that every State, irrespective of its political or economic structure, has to rely on such a bureaucracy so that to this extent the latter really represents a neutral instrument. However, a closer look at the situation shows that this is not the case.

If we begin by examining the facts in their historic perspective, it will be seen that the administering of a mercantilist State is often not subject to any definite rules but, at most, to internal administrative directives. Such intervention as took place was irregular and discretionary. The efficiency standards of civil servants and their supervision left much to be desired and their powers were often ill-defined or not even regulated at all. Even where rules and regulations existed, a local prince living during the mercantilist period considered himself to be competent for everything. In consequence, he could not very well declare that any sector of life was in principle beyond the reach of his bureaucrats. The court regulations issued, for example, by Margrave *Karl Friedrich von Baden* in 1766 are reminiscent of the language of the modern Welfare State. Despite this claim to totality, there was no completely centralized administration. What existed was a haphazard and motley mixture of independent trade, a marketing system and state interference. The characteristic features of a bureaucracy cited by *Max Weber* hardly existed.

By comparison, the liberal State of the 19th century was subject to clear limits and circumscribed powers. In consequence, it proved possible to define the powers of the bureaucracy more precisely. The choice of political and economic instruments was also marked by the relinquishment of the previous pragmatism and extemporization. This may be seen from the fact that monetary policy was no longer an instrument of trade policy and, by the same token, that barriers to international trade were no longer an instrument of monetary policy. Hence, it is fallacious to allege that the mercantilist bureaucracy was able more or less to retain all its old principles during the liberal era by virtue of its sheer inertia and tenacity. The survival of these legends resulted in no small measure from the restraint shown by the liberals in propagating their reforms in public administration. They were so preoccupied with the task of marking out the limits of government activity and creating the legal, regulative framework for a market economy that it did not seem worthwhile for them to stress their own contribution towards founding the modern State and its administration. None the less, it was only the transition to a liberal constitutional State and the market-economy system dependent upon it which furnished an opportunity for overcoming the imperfections of the administrative apparatus under mercantilism and for making administration itself a useful instrument in the service of the State.

As the liberals repressed this political achievement of theirs, people have tended to overlook one fundamental fact of practical administration: the management of public affairs becomes all the more efficient, the more clearly its functions are defined. Under a mercantile interventionist form of government, it is very difficult if not impossible to give an explicit

definition of the State's administrative functions. Hence, the public administrative service cannot be completely efficient under such a system.

It may well be that the magnitude of public administration remained the same during the liberal era or even increased both in absolute terms and as a percentage of the national income in line with the expanding economy. At the beginning, this was not so important for the functioning of the civil service. The expansion of public authorities (with the attendant administrative burdens) was offset by the benefits of rationalization. The paramount factor in this situation consisted in the permanent and unambiguous demarcation between the sphere of private autonomy and the options of governmental intervention. This established a sense of sureness not only among private individuals, but also in particular among officials as to their rights and duties.

In order to implement their aims, liberal propagandists had to appeal to the citizens so as to be able to use them if need be as «revolutionary potential» against the omnipotent mercantilist State. It would have required too much intellectual subtlety to convince the masses that the principles of liberal separation not only granted the citizens more freedom but also conduced towards a more efficient civil service. Moreover, an accentuation of this fact would have been detrimental to the attainment of liberal political goals, since the power applied by the mercantilist régimes with their authoritarian regulation, control and exploitation of the population had become suspect in itself and unworthy of further encouragement. In consequence, a misinterpretation was elevated to the dignity of an undisputed scientific doctrine and retained right up to the present age, i. e. the opinion that liberalism had weakened and neglected public administration. Lassalle's dictum on the nightwatchman-State (a role which the liberals are said to have promoted) is still popular. However, this phrase has a macabre ring about it, implying as it does that the liberal State was a weak-kneed and bullied State. But at least it proved to be more capable of safeguarding the public peace than the neo-mercantilist States of the present time. It was a less frequent occurrence in those times to find the State allowing itself to be intimidated by organized terror or even withholding the protection of the law against the illegal use of force from certain sections of the population and even from its own officials – as regularly takes place today in regard to teachers and university lecturers, for example.

The liberals knew perfectly well that every developed market economy fulfils a night-watchman's role only as a minimum requirement and that it also depends on the public administration discharging its duties properly. As a practical-minded holder of public office, *Adam Smith* drew up a truly wide-ranging list of state functions which, in his opinion, would have to be discharged under a market economy. Be that as it may, he linked his catalogue of duties to a merciless and highly detailed criticism of contemporary public services. In addition to the now no longer self-evident task incumbent upon a State to provide for internal and external security including the administration of justice, *Adam Smith* also drew attention to a third sector which we would nowadays vaguely designate as infrastructural policy. Admittedly, he defined this sector in more explicit terms than is customary today. He viewed it as embracing such areas of production as are socially and economically indispensable, but not profitable for private enterprise. By contrast, today innumerable profitable undertakings in the private sector have been taken over by public authorities and then rendered unprofitable so that the dividing lines between necessary and superfluous governmental activities have gone under in a sea of neomercantilist interventions. *Adam Smith* and many others after him stressed the need for government services and the demarcation of their limits in the interest of national wealth, but also above all in the interest of the autonomy of the private sector of the economy. *Max Weber* also underscored the need in capitalism for an efficient administration: one which is not only tightly organized but also transparent and predictable.

Although the opposite question as to whether a well functioning political system also needs a market economy and in particular whether public administration thereby becomes

more efficient has not been completely thrust aside, it seldom attracts attention or detailed treatment. Nevertheless, it would be remarkable if this connection had been completely overlooked. It was chiefly the administrative experts who noted the phenomenon, but they naturally did not always have the time or inclination to describe it in scholarly works. They could not help noticing that public administration is bound to forfeit its vigour when invested with wide-ranging, albeit diffuse powers liable to daily change and that this problem can be resolved under a market-economy system because this system allows that the spheres of activity are delimited. An experienced administrator and minister under Louis XVI, Turgot, tried to save the French ship of state from mutiny by carrying out liberal reforms. Thanks to the inefficiency and corruption of the officials, the State continued on its course leading to catastrophe. Only the suicidal short-sightedness of the King and his feudal court favourites induced them to disregard the situation and to dismiss the only statesman who could have averted the calamity. As *Heckscher* once pertinently commented, it was left to the Revolution and to Liberalism to act as executors of the attempted rationalization which mercantilism had been unable to complete.

Even in Prussia, a catastrophe was necessary in order to bring about a reforming of the rigid public administration system. The views still being expressed today about the ostensible rationality of the mercantilist Prussian civil service are misleading . . . After their country's defeat and the collapse of the old system, resolute men also came to the fore in Prussia: *Stein* and *Hardenberg*, who had served the State for several decades but who were no more Prussian by birth than the military reformers *Scharnhorst* and *Gneisenau*. Prussia was re-founded on the basis of liberal reforms. Freedom of trade and market-economy principles were gradually introduced. The new spirit of the age was discernible in the instructions issued to the Prussian administrative service on 26 December 1808: «The most beneficial procedure for the State and its individual sectors is always to leave the trades to pursue their different natural courses, i. e. not to favour or elevate any single one of them by special support nor to constrain them in their foundation, implementation or dissemination, provided that this does not infringe the law or offend against religion, bonos mores and the Constitution of the State.»

This formed the fundament for Prussia's economic and political rise to supremacy within Germany in the 19th century when her liberal policy on foreign trade provided an advantageous starting position over a protectionist Austria.

Even in the 20th century, there are still many dedicated liberals and champions of a free market economy to be found in key positions of public administration. Their time often comes when mercantilist and interventionist experiments have ruined both the economy and the State. Names such as *Luigi Einaudi* in Italy, *Jacques Rueff* in France, *Ludwig Erhard* and *Alfred Müller-Armack* in Germany or *Reinhard Kamitz* in Austria exemplify a certain type of liberal functionary inspired by strong scientific convictions. In Great Britain during World War II, many liberal economists were appointed to governmental planning departments where they worked with great distinction, whilst the services of economists and liberal advisers alike were spurned in Germany. One can even go so far as to allege that a centrally directed economy functions better if it is in the hands of people who have put their economic knowledge to practical use in trying to solve the problems of a market economy.

Let us now consider what principles the liberals apply when summoned to restore an efficient public administration. At the same time, let us take a look in particular at their economic measures in order to pinpoint more clearly the relationship between the economic system and the functional efficiency of public administration. The main achievement by liberal reformers consists in their success in reducing the administrative machinery and concentrating the strength of the bureaucracy upon the key strategic functions. To this end, the administrative services have to accept the requisite degree of discipline. As many functions as possible are left to the market and to individual planners, whilst economic

controls are dismantled. But one of the most important reforms consists in restoring the virtually dissipated monetary and fiscal stability. It has become customary to regard these monetary and fiscal constraints as an instrument for disciplining private enterprise, which is no longer being supplied with that disinhibiting drug known as inflation. At least equal importance attaches to the fact that these constraints impose planning limits on the state bureaucracy. This forces the public administration to draw a distinction between essential and non-essential government activities and expenditure and also to refrain from an excessive multiplication of public authorities. Public authorities improve both in quality and in effectiveness when they undergo such slimming cures, whilst the national economy on which the state's development potential depends also advances. It should be added that the liberal art of administration includes an abundance of admonitions intended to ensure that the State does not degenerate by mistake from being a complementary factor into a surrogate for civic freedom and a parasite of the private sector.

Clearly, such governmental asceticism meets with little popularity despite its beneficial outcome for the State itself. Politicians desirous of achieving success with the effective but limited instruments of a liberal public administration have to muster up enough understanding for the functioning of a modern constitutional State and for a market economy based on individual freedom and independence. The observation uttered in despair by the Swedish Chancellor *Oxenstierna* about how little wisdom is applied in ruling the world has lost none of its topicality. Hardworking but mediocre politicians try to attain easy political success in democratic States by expanding government activities, favouring certain groups of voters and generally arousing the impression by means of legislative and administrative activities that they are accomplishing something for the country by hard work even in those areas where this is not feasible. After the liberals have provided for a regeneration of the economy and the State, there often remain sufficient reserves of every kind to usher in an attractive policy of national expansion the guise of more social welfare.

Needless to say, there is no lack of scientific arguments in favour of such an expansionary policy. The point is made by various writers that the market-economy system remains fundamentally unbalanced and that it must be stabilized by anticipatory regulation and steering of the socio-economic processes and not merely by subsequent crisis management. Economists have concerned themselves for decades with the instabilities of the market economy and the «failure of the market». A highly detailed theoretical and empirical examination has also been carried out of the opportunities for official anti-cyclical measures. No evidence has been adduced to show that the State must continuously expand public finances for stabilization purposes or intervene on an ever-growing scale in the private sector by means of very precise controls. The problem of making reliable forecasts has not been resolved. Even in those cases where approximate prognoses of the direction of events are possible, it follows just as frequently from these predictions that government activities are to be curtailed for the sake of stability. However, a continuous series of counter-measures by the Government to reverse economic trends puts the public authorities in a mood of continuous expectation of change. As a result, the range of complementary governmental services begins to fluctuate – particularly in respect of state investment. If one tries to cope with this situation by income variation and pre-emptive amendments in taxation, this renders the data for future economic planning permanently uncertain in the light of current taxation rates. In conjunction with an official policy of structural distortion, this state action in the form of maintenance subsidies and social welfare often tends to exercise a destabilizing impact on the economy and on planning.

By contrast, stabilizing regulative and competitive enactments clearly stem from liberal counsels. The major codifications in modern civil law and the adjoining areas of public law and indeed all regulatory laws of any true permanence are a creation of the liberal era and its aftermath. Our contemporary epoch seldom aspires to such stabilization. The tendency is to intervene in haphazard fashion without much oversight over the whole legal system and over

the functional principles of the modern market economy. The authorities notice some defect or grievance, hastily enact a law designed to rectify it and thereby generate new and greater evils elsewhere for whose adjustment new laws are needed. All this accomplishes absolutely nothing apart from unsettling trade and industry and wasting the personnel resources of the public authorities. Attention has often been drawn to the impossibility of rehabilitating the economy by these mercantilist practices¹. What people fail to see, however, is that public administration itself is bound to fall a victim to such a policy, too. In the meantime, the protests of overworked tax officials continue to go unheeded as do the ruminations of a Federal Chancellor who finds himself unable to read his gas bill but then goes on to appeal to the general public as head of the state bureaucracy that they should help in inducing the competent officials to process the granting of housing permits more expeditiously, even though the Federal Government itself had passed laws which cause such delays. It would hardly be possible to illustrate the perplexity of the country's leaders more graphically than by this example.

The more that politicians steer and direct the economy, the greater the growth in a vertically ramified pyramid of public authorities. Just as the increasing industrialization and preparation of modern warfare necessitate more and more personnel in direction, planning and logistics for one man at the front, so the number of bureaucratic intermediaries within a modern interventionist public administration grow, too, whilst the ranks of the officials in the frontline dwindle. Exaggerated controls and amendments to these controls now overburden the civil servants with regulatory functions and thus inspire procrastination. The supervising officials pass on the pressure exerted upon them to the frontline officials, who are then called upon in new internal regulations to work more. When subjected to this pressure and overstrain, the frontline officials develop counter-strategies by amalgamating into interest groups or else by expanding «organizational slack» in the form of working to rule². The opportunities for this lie in the more and more complex regulations issued by the supervising bureaucracy, whose division of labour fails to achieve sufficient coordination and thus continues to grow apace. As supervising officials do not receive an adequate flow of information from the frontline and often deem paperwork to be more important than genuine information, the counter-strategy of the frontline officials often succeeds despite its more or less disorganized form. Its appearance is in fact anticipated neither by the State nor the population.

But before that situation actually occurs, the civil service itself hardly has professional interest in offering any real resistance to the expansion of governmental activities. The greater chances of promotion and the prospects of power and influence exercise their seductive appeal. Not only in an army whose ranks are being expanded but also in a mushrooming administrative bureaucracy, there begins a very agreeable phase for the members of the administration. As *Alexis de Tocqueville* stressed and *Max Weber* repeated, both the State and officialdom are quite prepared to carry out their administrative duties in the well-intended service of those to be ruled and made fortunate by them! However, that requires a wide-ranging network of new formal or formalistic regulations adapted as closely as possible to the actual or supposed requirements of the day.

This Fall from Grace ushers in the degeneration of public administration, particularly if the external manifestations of the constitutional State and of constitutional and legally fixed controls are to remain intact. The administration cannot simply order what it likes. It must insist on a stream of new laws and administrative provisions being issued in order to meet the requirements of a paternalistic welfare system. This is believed the only means to achieve a welfare-promoting fine-tuning. Even the most zealous legislators find it difficult to keep up with such a continuous demand for more legislation. This is clearly evidenced by the alarming deterioration in the linguistic and juridical quality of statutes. The amendments to laws and ordinances follow each other in rapid succession in line with the frantic attempts to fit a whole range of different subjects into the same administrative straitjacket. Even the

smallest community feels it is obliged to fill the local newspapers with a plethora of new statutes, amendments and public notices. But these bylaws are not enough in themselves and they have to be augmented by explanations and implementing regulations – all of which are expected to be carefully noted together with all amendments not only by the bureaucrats but also by the citizens i. e. if everything is done in strict conformity with the rules. The upshot of all this is of course that the bureaucracy loses its way in its own jungle of red tape. One pathetic example of this may be seen in the public notice put up in a small German village on 23 November 1978. This stated that married couples who would be celebrating their 50th, 60th, 65th or 70th wedding anniversary in 1979 together with all persons who would reach the age of 100 in that year should inform the Town Hall of this and present evidence in the form of their marriage or birth certificates. The presentation of gifts as a mark of recognition was being planned, but the administrative authorities had unfortunately been unable to ascertain how many jubilees would fall due!

In the cases of overregulation and legal control the central government eases its own burden to a certain degree by obtaining substantial powers from parliament in order to avoid the exhausting business of parliamentary processing and concomitant publicity. From time to time, a court to which one of the afflicted citizens has appealed rules that the matter must be settled by means of a formal law. Parliament then has reluctantly to turn its attention to the matter. But no real changes of any substance have in fact taken place.

Parliamentary activities have completely altered in character since the liberal era. The national assembly has evolved from a genuine legislative into a special kind of administrative body pouring out decrees and ad hoc decisions in the form of laws. However, the issue of detailed provisions usually overtakes the physical and mental capacity of a parliament. What can an average M. P. say about amendments to the market regulation for sugar, an Act to compensate victims of bankruptcy, the Law on Rubbish Disposal or the preliminary law on the University Reform Law? If given enough time, he can familiarize himself with the subject. However, the rapid succession of laws leaves him no time. In consequence, the principle of a division of labour comes to the fore. Each piece of legislation is assigned to a small group of M. P.s with special knowledge of the subject – mostly such parliamentarians as take a particular political or professional interest in the subject or as have developed a missionary spirit in certain fields. As the other M. P.s possess no special knowledge of the subject, they usually accede to their colleagues' wishes or even abstain from voting altogether. They take care not to intervene in the «royal prerogative» of other members, because they themselves are specialists in another field and wish to continue operating there with as little disturbance as possible. Only in this way can an administering assembly organize itself properly if it wishes to rule comprehensively and nevertheless with the help of formal laws.

A further complication arises in the administrative processes in a modern interventionist State like the Federal Republic of Germany in that the authorities wish on the one hand to control all areas of the economy and of life but on the other hand have a bad conscience at such authoritarian action because no-one wishes to, or may, ignore individual rights of freedom as set out in the Constitution of a State and inspired by the rule of law. The way out of this dilemma would appear to be a shift in priorities among the administrative officials whereby the supreme authorities delegate a large number of powers (including in particular those which are disagreeable to discharge and which can hardly be expected to engender any mass publicity or fame) to the frontline and subordinate administrative units. This in turn creates the problems of an accretion in power among the subordinate authorities and also of coordination between decentralized bureaucracies. The solution which politicians find most expedient usually consists in destabilizing the subordinate authorities and thus in intimidating the frontline officials. It would be insufficient simply to describe this destabilization under the heading of «democratization» and «publicity». At first the individual civil servant's powers of decision are circumscribed and then tied to a departmental consensus in

the same way as the mercantilist State used to do with its ponderous system of boards and councils. What the great liberal *John Stuart Mill* remarked on this and on public administration in general is as true as ever, «What the Board does is the act of nobody; and nobody can be made to answer for it»¹.

The confidentiality of discussions inside of a committee frees the members from much of the need to take certain factors into consideration and the individual official's interest in arriving at a proper decision only remains undiminished if he belongs to the body in question for a long period of time. By the same token, a short term of membership tends to encourage a feeling of not really being responsible for what happens. However, today's grass-roots democrats place less and less importance on a mandate conferred by tenure of office and, instead, give preference to an incessant rotation of responsible members contingent upon successful election². By the time that they have familiarized themselves with the subject and – following the example of American presidents – have had time enough to learn from their administrative mistakes, their period of office has already expired. There is a great temptation to minimize personal inconvenience during the familiarization phase, to exploit one's office for pursuing personal objectives and to bequeath to the next government all the consequences of one's activities – including the piles of unfinished work. In order to be able to determine the individual behaviour of each official, however, the demand has been voiced that the details of committee meetings should be made known and, in some cases (such as at the universities), this wish is more or less complied with.

Where an official receives a temporary appointment only and thus remains dependent upon re-election, he will be forced to act like a politician and he will find that he can no longer emancipate himself from the voters in his locality or interest group. If he is raised on the shield by his colleagues and subordinates, he may become the representative of the whole group. If a local electorate has put him into office, he will first of all have to take their wishes into consideration. To the extent that a public authority fulfils tasks which primarily concern such an electorate, there can be less objection to this. Municipal self-administration once rested on such principles and at least proved its value inasmuch as it granted the office-holders adequate authority and a sufficiently long tenure of office. But how can one employ such administrators to steer the economy on the basis of macroeconomic considerations? This question becomes particularly acute if the officials appointed pursuant to strict professional selection criteria are expected to work in the various administrative bodies alongside dilettantes chosen pursuant to proportional representation. The central authorities will still rely on the professional officials for the implementation of their instructions, but the latter will find it more and more difficult to carry these out due to the process of democratization and publicity. If one were to consider the whole issue in terms of a theory of games, the frontline officials could now decide to play a strategic game against both customers and elected co-officials as well as against the supervising authorities and thereby aspire to optimum results for themselves.

The reaction at the headquarters is predictable. As it cannot rely entirely on elected group-representatives who are not properly trained and selected professional civil servants, it will augment disciplinary pressure on the permanent officials. Furthermore, it will make the recalcitrant subordinate authorities accept its central objectives by issuing detailed administrative provisions. These provisions become all the more preposterous, the more they go into detail because the supreme authorities possess neither the information nor the experience to decree appropriate arrangements. The old Prussian and highly commendable tradition that every senior official must have personal experience of the activities of his junior officials and also undertake regular inspection visits to acquaint himself with the latest changes at the front has been lost in the mists of time. Such practices would miscarry today simply because of the immeasurable profusion of government activities.

Furthermore, there is a growing trend among the politically appointed senior civil servants to acquire via parliament and the political parties a right to influence and permanent

tenure within the state machinery. Although this is quite natural in view of the wish for a not so much professional as political administration which will manage the economy, the lack of administrative expertise among senior political appointees often yields absurd results. Nor is it a valid argument that the headquarters regularly order its frontline officials to report and also invites comments on the envisaged ordinances and provisions so that the specialized knowledge of the professional and frontline men can actually be incorporated into the decision-making process. These hearings have long since degenerated into a ritual such as that in Parliament, serving merely to clothe political decisions already taken during an often highly opaque process in a pseudo-democratic mantle.

Inasmuch as the right to a hearing exists not only for the frontline authorities but also for commercial interest groups, the extent to which these groups can form an administration hinges on their size, nature and influence. Since the neo-mercantilist type of interventionist administration is bound to favour certain groups and to discriminate against others, the influence wielded by groups on administrative decisions becomes a real necessity for the private sector. The civil service has in fact to rely on such influences. Inasmuch as the public administration wishes to steer the economy in detail, it must develop specialized authorities whose mentality normally assimilates to that of the branches of the economy and of the groupings to be regulated – especially since the specialist officials may later be offered lucrative positions in private trade or industry. In turn, the private sector must speculate against the regulatory State and it will achieve better results in this if it can poach highly qualified men from the bureaucracy's general staff and use them for developing a counter-strategy. It would be a fallacy to assume from this that all steering and supervisory authorities become corrupt. Inasmuch as the information provided by the interest groups is correct, that may even improve the decisions taken by the public authority. Moreover, supervisory authorities evolve seigniorial instincts towards their charges. But once that a certain department according to its judgement has corrected the actions and performance of a branch of the economy, it defends this decisions in conjunction with that branch against any alterations which the central authority may plan – if only to prove that it does not lack the requisite degree of specialized knowledge. The same holds true of the experts in parliament with the consequent emergence of an «iron triangle» comprising specialists from the private sector, public administration and parliament.

But that is not all. As long as a constitutional State remains intact, all its administrative acts are subject to judicial scrutiny and indeed they may be reversed by the courts even after years. The number of legal cases to be decided increases in parallel with the number of administrative items and laws. The courts must often examine the legality of administrative acts disguised as laws so that these rulings become a kind of subsidiary administration. It is said that the constitutional State (Rechtsstaat) is deteriorating into a system where normal legal procedures are misused in favour of vested interests and it is claimed that «administration as an independent function of the state» should be freed again from the multitude of legal restraints. In a modern administrative State with all its comprehensive steering apparatus, the contradiction between the constitutional State and administrative efficiency does not prove amenable to a solution. As a consequence of the logic of their system, there is fundamentally no judicial protection in communist States against the measures taken by the administrative authorities, because the central direction of the economy would collapse if courts were to detach parts of the coherent edifice of state planning by individual ad hoc decisions.

This deterioration in the civil service is accompanied by a change in the calibre of the officials. During the liberal era, the State satisfied itself with a limited number of civil servants and was able to make high demands of them. This situation changed upon the expansion of the machinery of State. Although specialization and a division of labour involving less qualified persons can help to maintain a well functioning administration, there arises an increased demand for civil servants with the requisite intellectual capabilities for

supervisory and coordinative functions. People who qualify for leading positions in the civil service are a much rarer occurrence than gifted entrepreneurs (who are themselves thinly scattered). The upshot of this is the emergence of a «law of diminishing personnel returns». As it grows, the civil service has to be satisfied with less capable officials. If this selection is then downgraded because our present epoch dislikes the whole concept of an élite, the fall in the quality of personnel is usually accompanied by a reduction in the functional efficiency of the public service.

Another point. The neo-mercantilist interventionist State of the present time generates a new type of official. It is no longer sufficient for a civil servant to command a good grasp of his subject, to be able to think in terms of the law and to possess a firm character. He must also possess the ability to manoeuvre between the various forces impinging upon the administration. He has to establish compromises between fidelity to the law, obedience to the political leaders, agreement with group interests and a good image vis-à-vis the general public. As the political system has legalized and institutionalized the safeguarding of group interests, the officials can unashamedly place their own interests to the fore, too. But for the civil servants it is difficult to find a common denominator for all these things. In such a pattern of forces, the qualities which lead to success are those for which Machiavelli's prince was famous: an instinct for power, a command of obstructionist techniques coupled with a simultaneous capacity for self-delineation, the ability to form coalitions and to parry the advance of other coalitions etc⁵. But the chief attribute is an instinct for noting which way the wind may be blowing and for turning one's coat accordingly. For, in an interventionist State, the desired measures and opportunities change from one day to the next. As long as a civil servant thinks in terms of professional standards and practical necessities – and this may be assumed of the bulk of public officials – he must be constantly prepared to counteract non-objective influences and requirements. But one of the principal problems remains the authorities' organizational structure which then becomes a political issue so that, even if an official's appointment is not a matter which the politicians can influence, the status and quality of his position are. For this reason, a civil servant must incorporate this incessant reorganization within his sphere of activities. In view of this, it seems small wonder that he also acquires egoistic habits which were at least repressed under the liberal constitutional State.

Another factor is that the neo-mercantilist system as a whole, like the ancien régime, lacks the self-preservation instinct which the theorists expect to find in every smoothly functioning system. Both in private and now more frequently in public, political leaders entertain hopes of a fundamentally different State. Nevertheless, they have at their command a body of officials who have sworn to observe the law and constitution as they now stand: in the case of soldiers and policemen, they have even taken an oath to defend it with their lives. This contradiction bears the seeds of its own self-destruction. The technique of unscrupulous manoeuvring and two-faced opportunism is certain to spread among the grass roots unless timely steps are taken to prevent this.

What can be done to overcome the dilemma and palsy of a modern administration such as we have described above? As far as the identity of the officials is concerned, the changeover to a totalitarian one-party State with a replacement of the existing civil servants may bring about the alignment of the administrative apparatus with the goals and the framework of a centrally steered economy. Alternatively, a clear return to a market economy and constitutional system is preferred. A market economy confers the advantage of improving the public administration by virtue of the fact that the civil servants can contradict or leave the service without undertaking any intolerable personal and economic risk. After all, private capital formation as a financial reserve remains permissible and, besides, the State is not the sole employer as under a centrally directed economy. But, broadly speaking, the observation made by *August Wilhelm Rehberg* at the beginning of the last century still applies: «Whatever may be attempted in order to perfect the management of public affairs is in fact

fruitless if the mentality peculiar to the public service, which sees its duties as being superior to any private interest because it concerns the general interest, simply disappears.»

As far as the problem of coordinating the highly ramified interventionist authorities under a neo-mercantilist mixed economy is concerned, lateral contacts with other departments can easily be prescribed more than hitherto as a step towards countering group-selfishness. But it is by no means certain that this will ensure the attainment of an efficient result from the standpoint of the economy as a whole. Horse-trading often takes place between the various branches of government whereby the seemingly irrational acts of another department are accepted on condition that the other department is willing to make concessions in turn. But the main objection is that not all the departments concerned can possibly enter into contact with each other prior to the implementation of an administrative act, because one does not always know in the case of an economic measure how and upon whom it will fall in practice and what departments ought to be consulted. Moreover, the long-winded nature of such horizontal coordination stands out of all proportion to the claim advanced by the interventionist administrators that they can swiftly and effectively deal with any aberrations in the free-market system.

Another remedy would be to reduce the complexity of the subject matter. This simplification may be carried out in one of two ways. Firstly, a genuine centrally administered economy may be introduced. In this case, constitutional principles and the rule of law are set aside in the interest of an efficient state administration. The co-determination hitherto accorded to groups inside of the state administration may at least formally be replaced by simple hierarchical relationships and by re-establishing official powers and responsibilities. Moreover, enterprises may be deprived of their independence so as to restrict their opportunity for a counter-strategy. In this way, they become a kind of state sub-department subject to government instructions. This in turn substantially reduces a complex and overlapping form of dual planning by the private sector and the civil service for one and the same economic process. The system can then be simplified by centralization and standardization, but it thereby forfeits some of its flexibility because of the stereotyped uniform solutions offered for various different subjects. The organizational weaknesses of a centrally administered economy are obvious even though such a state administrative system enjoys certain advantages of rationality compared with the mercantilist mixed system by virtue of its greater transparency, the predominance of the obedience principle and the sole responsibility of the State for all processes. In ideal circumstances, officials are provided with clear instructions and powers; they are expected to carry out the planned procedures with due fidelity; and their discretionary freedom is confined to the framework stipulated by the supreme authorities. Nevertheless, such a system tends towards bureaucratic sclerosis just like the state machinery under Frederick the Great. Where a civil servant takes an entrepreneurial decision, he will accept the credit for it in the event of a felicitous outcome but pass on the blame to his subordinates if it fails. Experiments are therefore not recommended and cannot simply be permitted without further ado, since officials are dealing with government property. Revolutionary changes are the sole preserve of the Government, which lays claim to superior knowledge and often undertakes enormous experiments involving excessive risks. These risks are not only so momentous simply because major unilateral experiments fail to give sufficient consideration to the whole nexus of uncertain factors. The renunciation of a market-economy price system also impairs the orientation in the process of finding new and better solutions. However organizationally viable a public service may be, it often stumbles wildly in all directions once that its economic compass has been removed.

The second path leading to a reduction of the complexity of public administration is the liberal one. In this case, too, we must not neglect elementary principles of organization. A civil servant should be bound by laws marked by a maximum of permanence as well as by clear-cut internal instructions which permit him to recognize the sense of the latter and to

reach his decision within a fairly generous framework of discretionary freedom. In a liberal State, the carefully selected body of civil servants can be allowed to act and think independently because the freedom of action claimed by the State is circumscribed. In a market economy, it is also possible to make some individual authorities independent and to subject them to rules of conduct with long-term validity without any damage to the system as a whole. That applies, for example, to: central banks, savings banks, social insurance institutions, transport undertakings, forestry authorities, state universities and the courts. This granting of administrative independence does not imply that these authorities receive such freedom as they may consider appropriate. On the contrary, they are bound by laws and provisions whose regulative implications have been carefully taken into account as regards their consistency with the general economic and political order and thus removed from day-to-day politics. It would be erroneous to assume that a bureaucracy which has limited its powers and committed itself more to rules and enactments than to comprehensive central planning is manifestly lacking in imagination, flexibility and a sense of responsibility. The experience gained during the liberal era proves the contrary.

If the civil service is to function smoothly, then any attempt to establish a permanent and pragmatic compromise between the above-mentioned alternatives would be out of place. An interventionist state with a claim to total rule over all aspects of life, yet not determined to transform itself into a full centrally planned economy, ruins not so much the economy as itself and its own administration⁶. An extension in the powers of the public administrative service does not necessarily imply a more effective bureaucracy. If such a bureaucracy becomes more and more concerned with the task of administering itself and laboriously plodding along like some misshapen dinosaur, then not only the economy is in jeopardy but also the State.

1 Not so well-known is the fact that public administration is paralysed itself, i. e. by the same measures of dirigism which are applied to the private economy. The executive authorities, which are in direct contact with the public, are incessantly swamped with continually changing organization principles, administrative regulations, rules and directives. Since the correspondence with public authorities is confidential, documentation such as can be compiled in the private economy is impossible. In the case of public institutions with a high degree of independence like universities, however, the organizational slack and confusion caused by the controlling authorities can hardly be concealed any longer.

2 It is rather odd that on the one hand new directives are continually issued with the pretended purpose that, through their exact application, public objectives will be better realized while on the other hand it is the very application of these directives which hinders the practical work of the administration. Apparently those issuing such directives assume that the officials apply them with more or less of a discount, i. e. that they do not take them all too seriously. It is quite normal that in many cases an official has to have a scope of judgement which allows him to react either in a reserved manner or encouragingly. Yet it is strange if an official may be faced with disciplinary consequences in case he follows instructions literally. One had better take disciplinary steps against those who issued such inapplicable directives.

3 Cp. *John Stuart Mill, Utilitarianism, Liberty and Representative Government*, Everyman's Library No. 482, London, last reprint 1960, p. 333.

- 4 The democratizing equalization of students, assistants and professors in German universities, for example, has greatly increased the number of those members in administrative bodies who are not constantly tied to the administration of the universities; since wrong decisions have no effect on them, they only take a limited interest in acquiring profound knowledge about administrative procedures.
- 5 In this context, it is of special concern that even officials must fail to be completely obedient to laws and directives. The reason is that for the multitude of these laws and directives they simply cannot even become familiar with all those concerning their own field of activity, let alone with those concerning neighbouring ones. This holds all the more true if the officials are not lawyers. Consequently, everybody is vulnerable and can be blackmailed and made amenable by the threat that his way of executing his duties will be subjected to a thorough inspection as to whether it is in compliance with the relevant laws and directives or not. In order to avoid such pressure, officials become amenable also in those cases in which an appropriate dealing with a cause would require an uncompromising attitude. An official who wants to perform his duties properly, however, cannot but violate devious directives and instructions.
- 6 Cp. *Carl Schmitt*, *Weiterentwicklung des totalen Staats in Deutschland*, (1933), in: *Carl Schmitt*, *Verfassungsrechtliche Aufsätze aus den Jahren 1924–1954*, Berlin 1958, p. 359–366, particularly p. 362: «The German State of today is total because it is weak and because it succumbs, because it is incapable of resisting the pressure of political parties and organized interest groups. It has to yield to everybody, subsidize everybody and simultaneously please contradictory interests. As pointed out before, its expansion is a consequence not of its strength but of its weakness.»

b. State Intervention

Of the Wise Limitation of Statesman

Adam Ferguson

1767

[. . .] The growth of industry, the endeavours of men to improve their arts, to extend their commerce, to secure their possessions, and to establish their rights, are indeed the most effectual means to promote population: but they arise from a different motive; they arise from regards to interest and personal safety. They are intended for the benefit of those who exist, not to procure the increase of their numbers.

It is, in the mean time, of importance to know that where a people are fortunate in their political establishments, and successful in the pursuits of industry, their population is likely to grow in proportion. Most of the other devices thought of for this purpose, only serve to frustrate the expectations of mankind, or to mislead their attention.

In planting a colony, in striving to repair the occasional wastes of pestilence or war, the immediate contrivance of statesmen may be useful; but if in reasoning on the increase of mankind in general, we overlook their freedom, and their happiness, our aids to population become weak and ineffectual. They only lead us to work on the surface, or to pursue a shadow, while we neglect the substantial concern; and in a decaying state, make us tamper with palliatives, while the roots of an evil are suffered to remain. *Octavius* revived or enforced the laws that related to population at Rome: but it may be said of him, and of many sovereigns in a similar situation, that they administer the poison, while they are devising the remedy; and bring a damp and a palsy on the principles of life, while they endeavour, by external applications to the skin, to restore the bloom of a decayed and a sickly body.

It is indeed happy for mankind, that this important object is not always dependent on the wisdom of sovereigns, or the policy of single men. A people intent on freedom, find for themselves a condition in which they may follow the propensities of nature with a more signal effect, than any which the councils of state could devise. When sovereigns, or projectors, are the supposed masters of this subject, the best they can do, is to be cautious of hurting an interest they cannot greatly promote, and of making breaches they cannot repair.

«When nations were divided into small territories, and petty commonwealths, where each

man had his house and his field to himself, and each county had its capital free and independent; what a happy situation for mankind,» says *Mr. Hume*, «how favourable to industry and agriculture, to marriage and to population!» Yet here were probably no schemes of the statesman for rewarding the married, or for punishing the single; for inviting foreigners to settle, or for prohibiting the departure of natives. Every citizen finding a possession secure, and a provision for his heirs, was not discouraged by the gloomy fears of oppression or want: and where every other function of nature was free, that which furnished the nursery could not be restrained. Nature has required the powerful to be just; but she has not otherwise intrusted the preservation of her works to their visionary plans. What fewel can the statesman add to the fires of youth? Let him only not smother it, and the effect is secure. Where we oppress or degrade mankind with one hand, it is vain, like Octavius, to hold out in the other, the baits of marriage, or the whip to barrenness. It is vain to invite new inhabitants from abroad, while those we already possess are made to hold their tenure with uncertainty; and to tremble, not only under the prospect of a numerous family, but even under that of a precarious and doubtful subsistence for themselves. The arbitrary sovereign, who has made this the condition of his subjects, owes the remains of his people to the powerful instincts of nature, not to any device of his own.

[. . .] Men are tempted to labour, and to practise lucrative arts, by motives of interest. Secure to the workman the fruit of his labour, give him the prospects of independence or freedom, the public has found a faithful minister in the acquisition of wealth, and a faithful steward in hoarding what he has gained. The statesman in this, as in the case of population itself, can do little more than avoid doing mischief. It is well, if, in the beginnings of commerce, he knows how to repress the frauds to which it is subject. Commerce, if continued, is the branch in which men committed to the effects of their own experience, are least apt to go wrong.

The trader, in rude ages, is short-sighted, fraudulent, and mercenary; but in the progress and advanced state of his art, his views are enlarged, his maxims are established: he becomes punctual, liberal, faithful, and enterprising; and in the period of general corruption, he alone has every virtue, except the force to defend his acquisitions. He needs no aid from the State, but its protection; and is often in himself its most intelligent and respectable member. Even in China, we are informed, where pilfering, fraud, and corruption, are the reigning practice with all the other orders of men, the great merchant is ready to give, and to procure confidence: while his countrymen act on the plans and under the restrictions of a police adjusted to knaves, he acts on the reasons of trade, and the maxims of mankind.

If population be connected with national wealth, liberty and personal security is the great foundation of both: and if this foundation be laid in the state, nature has secured the increase and the industry of its members; the one by desires the most ardent in the human frame; the other by a consideration the most uniform and constant of any that possesses the mind. The great object of policy, therefore, with respect to both, is, to secure to the family its means of subsistence and settlement; to protect the industrious in the pursuit of his occupation; to reconcile the restrictions of police, and the social affections of mankind, with their separate and interested pursuits.

In matters of particular profession, industry, and trade, the experienced practitioner is the master, and every general reasoner is a novice. The object in commerce is to make the individual rich; the more he gains for himself, the more he augments the wealth of his country. If a protection be required, it must be granted; if crimes and frauds be committed, they must be repressed; and government can pretend to no more. When the refined politician would lend an active hand, he only multiplies interruptions and grounds of complaint; when the merchant forgets his own interest to lay plans for his country, the period of vision and chimera is near, and the solid basis of commerce withdrawn. He might be told, perhaps, that while he pursues his advantage, and gives no cause of complaint, the interest of commerce is safe.

The general police of France, proceeding on a supposition that the exportation of corn must drain the country where it has grown, had, till of late, laid that branch of commerce under a severe prohibition. The English landholder and the farmer had credit enough to obtain a premium for exportation, to favour the sale of their commodity; and the event has shown, that private interest is a better patron of commerce and plenty, than the refinements of state. One nation lays the refined plan of a settlement on the continent of North America, and trusts little to the conduct of traders and short-sighted men; another leaves men to find their own position in a state of freedom, and to think for themselves. The active industry and the limited views of the one, made a thriving settlement; the great projects of the other were still in idea.

But I willingly quit a subject in which I am not much conversant, and still less engaged by the views with which I write. Speculations on commerce and wealth have been delivered by the ablest writers, who have left nothing so important to be offered on the subject, as the general caution, not to consider these articles as making the sum of national felicity, or the principal object of any state.

One nation, in search of gold and of precious metals, neglect the domestic sources of wealth, and become dependent on their neighbours for the necessities of life: another so intent on improving their internal resources, and on increasing their commerce, that they become dependent on foreigners for the defence of what they acquire. It is even painful in conversation to find the interests of trade give the tone to our reasonings, and to find a subject perpetually offered as the great business of national councils, to which any interposition of government is seldom, with propriety, applied, or never beyond the protection it affords.

We complain of a want of public spirit; but whatever may be the effect of this error in practice, in speculation it is none of our faults: we reason perpetually for the public; but the want of national views were frequently better than the possession of those we express: we would have nations, like a company of merchants, think of nothing but the increase of their stock; assemble to deliberate on profit and loss; and, like them too, intrust their protection to a force which they do not possess in themselves.

Because men, like other animals, are maintained in multitudes, where the necessities of life are amassed, and the store of wealth is enlarged, we drop our regards for the happiness, the moral and political character of a people; and anxious for the herd we would propagate, carry our views no farther than the stall and the pasture. We forget that the few have often made a prey of the many; that to the poor there is nothing so enticing as the coffers of the rich; and that when the price of freedom comes to be paid, the heavy sword of the victor may fall into the opposite scale.

Whatever be the actual conduct of nations in this matter, it is certain, that many of our arguments would hurry us, for the sake of wealth and of population, into a scene where mankind being exposed to corruption, are unable to defend their possessions; and where they are, in the end, subject to oppression and ruin. We cut off the roots, while we would extend the branches, and thicken the foliage.

Critique of Interventionism¹

Ludwig von Mises

1926

The problem of interventionism must not be confused with that of socialism. We are not dealing here with the question of whether or not socialism in any form is conceivable or realizable. We are not here seeking an answer to the question of whether human society can be built on public property in the means of production. The problem at hand is, What are the consequences of government and other interventions in the private property order? Can they achieve the result they are supposed to achieve?

[. . .] The emphasis of the system of interventionism is on price intervention.

Price intervention aims at setting goods prices that differ from those the unhampered market would set.

When the unhampered market determines prices, or would determine prices if government had not interfered, the proceeds cover the cost of production. If government sets a lower price, proceeds fall below cost. Merchants and producers will now desist from selling – excepting perishable goods that quickly lose value – in order to save the goods for more favorable times when, hopefully, the control will be lifted. If government now endeavors to prevent a good's disappearance from the market, a consequence of its own intervention, it cannot limit itself to setting its price, but must simultaneously order that all available supplies be sold at the regulated price.

Even this is inadequate. At the ideal market price supply and demand would coincide. Since government has decreed a lower price the demand has risen while the supply has remained unchanged. The available supply now does not suffice to satisfy the demand at the fixed price. Part of the demand will remain unsatisfied. The market mechanism, which normally brings demand and supply together through changes in price, ceases to function. Customers who were willing to pay the official price turn away in disappointment because the early purchasers or those who personally knew the sellers had bought the whole supply. If government wishes to avoid the consequences of its own intervention, which after all are contrary to its own intention, it must resort to rationing as a supplement to price controls and selling orders. In this way government determines the quantity that may be sold to each buyer at the regulated price.

A much more difficult problem arises when the supplies that were available at the moment of price intervention are used up. Since production is no longer profitable at the regulated

price, it is curtailed or even halted. If government would like production to continue, it must force the producers to continue, and it must also control the prices of raw materials, semifinished products, and wages. But such controls must not be limited to a few industries which government meant to control because their products are believed to be especially important. The controls must encompass all branches of production, the prices of all goods and all wages, and the economic actions of all entrepreneurs, capitalists, landowners, and workers. If any industry should remain free, capital and labor will move to it and thus frustrate the purpose of government's earlier intervention. Surely, government would like an ample supply of those products it deemed so important and therefore sought to regulate. It never intended that they should now be neglected on account of the intervention.

Our analysis thus reveals that in a private property order isolated intervention fails to achieve what its sponsors hoped to achieve. From their point of view, intervention is not only useless, but wholly unsuitable because it aggravates the «evil» it meant to alleviate. Before the price was regulated, the economic good was too expensive in the opinion of the authority; now it disappears from the market. But this was not the intention of the authority seeking to lower the price for consumers. On the contrary, from its own point of view, the scarcity and inability to find a supply must appear as the far greater evil. In this sense it may be said that limited intervention is illogical and unsuitable, that the economic system that works through such interventions is unworkable and unsuitable, and that it contradicts economic logic.

If government is not inclined to alleviate the situation through removing its limited intervention and lifting its price control, its first step must be followed by others. Its decree that set price ceilings must be followed not only by decrees on the sale of all available supplies and the introduction of rationing, but also price controls on the goods of higher order and wage controls and, finally, mandatory labor for businessmen and workers. And such decrees must not be limited to a single or a few industries, but must cover all branches of production. There is no other choice: government either abstains from limited interference with the market forces, or it assumes total control over production and distribution. Either capitalism or socialism; there is no middle of the road.

Let us take yet another example: The minimum wage, wage control. It is unimportant whether government imposes the control directly, or labor unions through physical coercion or threats prevent employers from hiring workers who are willing to work for lower wages. As wages rise, so must the costs of production and also prices. If the wage earners were the only consumers as buyers of the final products, an increase in real wages by this method would be inconceivable. The workers would lose as consumers what they gained as wage earners. But there are also consumers whose income is derived from property and entrepreneurial activity. The wage boost does not raise their incomes; they cannot pay the higher prices and, therefore, must curtail their consumption. The decline in demand leads to dismissal of workers. If the labor union coercion were ineffective, the unemployed would exert a labor marked pressure that would reduce the artificially raised wages to the natural market rate. But this escape has been closed. Unemployment, a friction phenomenon that soon disappears in an unhampered market order, becomes a permanent institution in interventionism.

As government did not mean to create such a condition, it must intervene again. It forces employers either to reinstate the unemployed workers and pay the fixed rate, or to pay taxes that compensate the unemployed. Such a burden consumes the owners' income, or at least reduces it greatly. It is even conceivable that the entrepreneurs' and owners' income no longer can carry this burden, but that it must be paid out of capital. But if nonlabor income is consumed by such burdens we realize that it must lead to capital consumption. Capitalists and entrepreneurs, too, want to consume and live even when they are earning no incomes. They will consume capital. Therefore, it is unsuitable and illogical to deprive entrepreneurs, capitalists, and land owners of their incomes and leave control over the means of production

in their hands. Obviously, the consumption of capital in the end reduces wage rates. If the market wage structure is unacceptable the whole private property order must be abolished. Wage controls can raise rates only temporarily, and only at the price of future wage reductions.

The problem of wage controls is of such great importance today that we must analyze it in yet another way, taking into consideration the international exchange of goods. Let us suppose that economic goods are exchanged between two countries, Atlantis and Thule. Atlantis supplies industrial products, Thule agricultural products. Under the influence of Friedrich List², Thule now deems it necessary to build its own industry by way of protective tariffs. The final outcome of Thule's industrialization program can be no other than that fewer industrial products are imported from Atlantis, and fewer agricultural products exported to Atlantis. Both countries now satisfy their wants to a greater degree from domestic production, which leaves the social product smaller than it used to be because production conditions are now less favorable.

This may be explained as follows: in reaction to the import duties in Thule the Atlantean industry lowers its wages. But it is impossible to offset the whole tariff burden through lower wages. When wages begin to fall it becomes profitable to expand the production of raw materials. On the other hand, the reduction in Thulean sales of agricultural products to Atlantis tends to lower wages in the Thulean raw material production, which will afford the Thulean industry the opportunity to compete with the Atlantean industry through lower labor costs. It is obvious that in addition to the declining capital return of industry in Atlantis, and the declining land rent in Thule, wage rates in both countries must fall. The decline in income corresponds to the declining social product.

But Atlantis is a «social» country. Labor unions prevent a reduction in wage rates. Production costs of Atlantean industry remain at the old pre-import-duty levels. As sales in Thule decline Atlantean industry must discharge some workers. Unemployment compensation prevents the flow of unemployed labor to agriculture. Unemployment thus becomes a permanent institution.

The exportation of coal from Great Britain has declined. Inasmuch as the unneeded miners cannot emigrate – because other countries do not want them – they must move to those British industries that are expanding in order to compensate for the smaller imports that follow the decline in exports. A reduction in wage rates in coal mining may bring about this movement. But labor unions may hamper this unavoidable adjustment for years, albeit temporarily. In the end, the decline in the international division of labor must bring about a reduction in standards of living. And this reduction must be all the greater, the more capital has been consumed through «social» intervention.

Austrian industry suffers from the fact that other countries are raising their import duties continually on Austrian products and are imposing ever new import restrictions, such as foreign exchange control. Its answer to higher duties, if its own tax burden is not reduced, can only be the reduction in wages. All other production factors are inflexible. Raw materials and semifinished products must be bought in the world market. Entrepreneurial profits and interest rates must correspond to world market conditions as more foreign capital is invested in Austria than Austrian capital in invested abroad. Only wage rates are determined nationally because emigration by Austrian workers is largely prevented by «social» policies abroad. Only wage rates can fall. Policies that support wages at artificially high rates and grant unemployment compensation only create unemployment.

It is absurd to demand that European wages must be raised because wages are higher in the U.S. than in Europe. If the immigration barriers to the U.S., Australia, et cetera, would be removed, European workers could emigrate, which would gradually lead to an international equalization of wage rates.

The permanent unemployment of hundreds of thousands and millions of people on the one hand, and the consumption of capital on the other hand, are each consequences of

interventionism's artificial raising of wage rates by labor unions and unemployment compensation.

Destruction Resulting from Intervention

The history of the last decades can be understood only with a comprehension of the consequences of such intervention in the economic operations of the private property order. Since the demise of classical liberalism, interventionism has been the gist of politics in all countries in Europe and America.

The economic layman only observes that «interested parties» succeed again and again in escaping the strictures of law. The fact that the system functions poorly is blamed exclusively on the law that does not go far enough, and on corruption that prevents its application. The very failure of interventionism reinforces the layman's conviction that private property must be controlled severely. The corruption of the regulatory bodies does not shake his blind confidence in the infallibility and perfection of the state; it merely fills him with moral aversion to entrepreneurs and capitalists.

But the violation of law is not an evil that merely needs to be eradicated in order to create paradise on earth, an evil that flows from human weakness so difficult to uproot, as etatists so naively proclaim. If all interventionist laws were really to be observed they would soon lead to absurdity. All wheels would come to a halt because the strong arm of government comes too close.

Our contemporaries view the matter like this: farmers and milk dealers conspire to raise the price of milk. Then comes the state, the welfare state, to bring relief, pitting common interest against special interest, public economic view against private point of view. The state dissolves the «milk cartel», sets ceiling prices, and embarks upon criminal prosecution of the violators of its regulations. The fact that milk does not become as cheap as the consumers had wished is now blamed on the laws that are not strict enough, and on their enforcement that is not severe enough. It is not so easy to oppose the profit motive of pressure groups that are injurious to the public. The laws must therefore be strengthened and enforced without consideration or mercy.

In reality, the situation is quite different. If the price ceilings were really enforced, the delivery of milk and dairy products to the cities would soon come to a halt. Not more, but less milk, or none at all, would come to the market. The consumer still gets his milk only because the regulations are circumvented. If we accept the rather impermissible and fallacious etatist antithesis of public and private interests, we would have to draw this conclusion: the milk dealer who violates the law is serving the public interest; the government official who seeks to enforce the ceiling price is jeopardizing it.

Of course, the businessman who violates the laws and regulations in order to produce regardless of government obstacles is not guided by considerations of public interest, which the champions of the public interest belabor continually, but by the desire to earn a profit, or at least to avoid the loss which he would suffer complying with the regulation. Public opinion, which is indignant at the baseness of such motivation and the wickedness of such action, cannot comprehend that the impracticability of the decrees and prohibitions would soon lead to a catastrophe were it not for this systematic disregard of government orders and prohibitions. Public opinion expects salvation from strict compliance with government regulations passed «for the protection of the weak». It censures government only because it is not strong enough to pass all necessary regulations and does not entrust their enforcement to more capable and incorruptible individuals. The basic problems of interventionism are not discussed at all. He who timidly dares to doubt the justification of the restrictions on capitalists and entrepreneurs is scorned as a hireling of injurious special interests or, at best, is treated with silent contempt. Even in a discussion of the methods of interventionism, he who does not want to jeopardize his reputation and, above all, his career must be very

careful. One can easily fall under the suspicion of serving «capital». Anyone using economic arguments cannot escape this suspicion.

To be sure, public opinion is not mistaken if it scents corruption everywhere in the interventionist state. The corruptibility of the politicians, representatives, and officials is the very foundation that carries the system. Without it the system would disintegrate or be replaced with socialism or capitalism. Classical liberalism regarded those laws best that afforded least discretionary power to executive authorities, thus avoiding arbitrariness and abuse. The modern state seeks to expand its discretionary power – everything is to be left to the discretion of officials.

We cannot here set forth the impact of corruption on public morals. Naturally, neither the bribers nor the bribed realize that their behavior tends to preserve the system which public opinion and they themselves believe to be the right one. In violating the law they are conscious of impairing the public weal. But by constantly violating criminal laws and moral decrees they finally lose the ability to distinguish between right and wrong, good and bad. If finally few economic goods can be produced or sold without violating some regulation, it becomes an unfortunate accompaniment of «life» to sin against law and morality. And those individuals who wish it were different are derided as «theorists». The merchant who began by violating foreign exchange controls, import and export restrictions, price ceilings, et cetera, easily proceeds to defraud his partner. The decay of business morals, which is called «inflation effect», is the inevitable concomitant of the regulations that were imposed on trade and production during the inflation.

It may be said that the system of interventionism has become bearable through the laxity of enforcement. Even the interferences with prices are said to lose their disruptive power if the entrepreneurs can «correct» the situation with money and persuasion. Durely, it cannot be denied that it would be better without the intervention. But, after all, public opinion must be accommodated. Interventionism is seen as a tribute that must be paid to democracy in order to preserve the capitalistic system.

This line of reasoning can be understood from the view-point of entrepreneurs and capitalists who have adopted Marxian-socialistic or state-socialistic thought. To them, private property in the means of production is an institution that favors the interests of landowners, capitalists, and entrepreneurs at the expense of the public. Its preservation solely serves the interests of the propertied classes. So, if by making a few painless concessions these classes can salvage the institution that is so beneficial to them, and yet so harmful to all other classes, why jeopardize its preservation by adamantly refusing the concessions?

Of course, those who do not share this view regarding «bourgeois» interests cannot accept this line of thought. We do not see why the productivity of economic labor should be reduced through erroneous measures. If private property in the means of production actually is an institution that favors one part of society to the detriment of another, then it should be abolished. But if it is found that private property is useful to all, and that human society with its division of labor could not be organized in any other way, then it must be safeguarded so that it can serve its function in the best possible way. We need not here discuss the confusion that must arise about all moral concepts if law and moral precepts disallow, or at least revile, something that must be preserved as the foundation of social life. And why should anything be prohibited in the expectation that the prohibition will be largely circumvented?

Anyone defending interventionism with such arguments is undoubtedly seriously deluded regarding the extent of the productivity loss caused by government interventions. Surely, the adaptability of the capitalist economy has negated many obstacles placed in the way of entrepreneurial activity. We constantly observe that entrepreneurs are succeeding in supplying the markets with more and better products and services despite all difficulties put in their way by law and administration. But we cannot calculate how much better those

products and services would be today, without expenditure of additional labor, if the hustle and bustle of government were not aiming (inadvertently, to be sure) at making things worse. We are thinking of the consequences of all trade restrictions on which there can be no differences of opinion. We are thinking of the obstructions to production improvements through the fight against cartels and trusts. We are thinking of the consequences of price controls. We are thinking of the artificial raising of wage rates through collective coercion, the denial of protection to all those willing to work, unemployment compensation, and, finally, the denial of the freedom to move from country to country, all of which have made the unemployment of millions of workers a permanent phenomenon.

Etatists and socialists are calling the great crisis from which the world economy has been suffering since the end of the World War the crisis of capitalism. In reality, it is the crisis of interventionism.

In a static economy there may be idle land, but no unemployed capital or labor. At the unhampered, market, rate of wages all workers find employment. If, other conditions being equal, somewhere workers are released, for instance, on account of an introduction of new labor-saving processes, wage rates must fall. At the new, lower rates then all workers find employment again. In the capitalist social order unemployment is merely a transition and friction phenomenon. Various conditions that impede the free flow of labor from place to place, from country to country, may render the equalization of wage rates more difficult. They may also lead to differences in compensation of the various types of labor. But with freedom for entrepreneurs and capitalists they could never lead to large-scale and permanent unemployment. Workers seeking employment could always find work by adjusting their wage demands to market conditions.

If the market determination of wage rates had not been disrupted, the effects of the World War and the destructive economic policies of the last decades would have led to a decline in wage rates, but not to unemployment. The scope and duration of unemployment, interpreted today as proof of the failure of capitalism, results from the fact that labor unions and unemployment compensation are keeping wage rates higher than the unhampered market would set them. Without unemployment compensation and the power of labor unions to prevent the competition of nonmembers willing to work, the pressure of supply would soon bring about a wage adjustment that would assure employment to all hands. We may regret the consequences of the antimarket and anticapitalistic policy in recent decades, but we cannot change them. Only reduction in consumption and hard labor can replace the capital that was lost; and only the formation of new capital can raise the marginal productivity of labor and thus wage rates.

Unemployment compensation cannot eradicate the evil. It merely delays the ultimately unavoidable adjustment of wages to the fallen marginal productivity. And since the compensation is usually not paid from income, but out of capital, ever more capital is consumed and future marginal productivity of labor further reduced.

However, we must not assume that an immediate abolition of all the obstacles to the smooth functioning of the capitalist economic order would instantly eradicate the consequences of many decades of intervention. Vast amounts of producers' goods have been destroyed. Trade restrictions and other mercantilistic measures have caused malinvestments of even greater amounts that yield little or nothing. The withdrawal of large fertile areas of the world (e.g., Russia and Siberia) from the international exchange system has led to unproductive readjustments in primary production and processing. Even under the most favorable conditions, many years will pass before the traces of the fallacious policies of the last decades can be erased. But there is no other way to the greater well-being for all.

1 Translated by Hans F. Sennholz. We are indebted to the Arlington House-Publishers, New Rochelle, for kindly allowance to reprint parts of this translation.

2 *Editor's note:* A nineteenth century (1789–1846) German advocate of the use of protective tariffs to stimulate national industrial development.

Liberal Intervention

Alexander Rüstow

1932

There prevails a wide measure of unanimity, especially among the more percipient members of society, that the current crisis in Germany has been largely precipitated by the interventionism and subsidization practised by the public authorities. It would be otiose to quarrel about the actual degree, since a quantitative determination is not possible, and since there are correlations with various other fields.

The existence of such unanimity might tempt one to derive consolation from the hope that an injury teaches us a lesson and renders us immune against a repetition of our error. But I think that none of us are seriously convinced of this. On the contrary, we all have the highly disquieting feeling that – as things stand today – similar processes with equally fatal results could at any time recur, and indeed will recur, unless firm and radical changes take place. This fact in itself shows that the causes of the situation extend far beyond the field of economic conditions and economic viewpoints. In the final analysis, the real issue is not one of discernment but of will power and of political and governmental action. I firmly believe that it is not the economy which determines our fate, but the State; and that the State also determines the fate of the economy.

If we take a clear look at the initial circumstances leading up to interventions and subventions, we usually find that some structural change or other (often emanating from an external source) has brought about a deterioration in competitive conditions for a certain branch of the national economy and that the authorities have intervened with a form of compensation in order to protect the afflicted sector.

The reactions to such a predicament are varied. One possibility is simply to do nothing and to let events take their course in conformity with the old maxim *laissez faire, laissez aller*. What happens then? The answer springs readily to mind. After all, the whole of classical national economy as applied to trade and industry consists of nothing else except virtually the answer to this question. There is no need for me to go into detail about this at this stage. A new equilibrium begins to take shape at some time or other following a whole

series of shifts in emphasis and of friction. There exists a measure of agreement – to which the academically trained representatives of interventionist views accede – that this new equilibrium, once achieved, represents the optimal allround solution. But those who espouse anti-liberal views pose the question as to when this condition supervenes and how many sacrifices and how much damage the victims have suffered in the meantime? For, after all, life has to be lived during the intervening period and, as *Keynes* noted, we are all dead in the long run.

If it appears intolerable to us today just to sit back and watch these things taking place and if we feel responsible for our fellow compatriots who have got into economic distress through no fault of their own, there is no need here in our Association for Social Policy to stress that this attitude in itself represents a social advance. Nor do I intend to speak of the exaggeration of such social attitudes whereby someone beset by small tribulations expects to get a very large medicinal plaster for it from the public authorities – a plaster which, in the final analysis, has to be cut out of our skin. (The reader will, I hope, forgive me this macabre, albeit accurate image). Compared with such self-pity, the highly censured school of Manchester liberalism also signifies a much more masculine and courageous stance. Moreover, the resistance and the capacity of the economy to withstand misfortunes have apparently been greatly underestimated. The calamity would by no means have been so great as it has now become because of the increased scale of ill-advised intervention if one had simply done nothing – with the sole exception of introducing unemployment pay – and let things take their course. An economy which has withstood the catastrophic consequences of this intervention as successfully as ours has done would easily have survived whatever hardships the illusory advantages of these interventions were supposed to be protecting us against.

However, this theory was never put to the test. On the contrary, the intervention was carried out in every case in a manner which is psychologically easy to explain and understand: we simply reacted to an external disturbance. Where for example a structural change in the world economy causes a drop in prices, the authorities hasten to implement measures from the unfortunately now very large arsenal of instruments – whether these be trading or other devices – in order to keep prices high. When incomes either fall or do not rise as much as desired, the difference is made up via general costs or public funds. And where capital losses loom or occur, the Government steps in with state guarantees or covers the damage from budgetary sources. The feature common to all these measures is that they are directed against the trends which would otherwise continue as before, the aim being to reverse them and preserve the status quo. Hence, this type of economic interference may be designated as reactionary in the literal and figurative senses of the term. But since the structural changes which one wishes to counteract in this way do not usually come to a standstill but in fact persist (because they are often protracted shifts in direction and marked by a tendency to grow stronger), the scale of intervention in the opposite direction has to increase and assume sharper forms in order to achieve the desired effect. Furthermore, those concerned soon become habituated to this helping hand. The medicine seems quite tasty really and the appetite is easily stimulated. And all this then results in the familiar «bottomless barrel» and the dire results facing us.

In view of this outcome, we should ask ourselves whether we truly have only the option of either letting things take their course or else interfering in this forlorn and fatal manner to prevent processes from operating naturally? I do not believe this to be the case. I think there exists a third type of attitude, which would be the correct and modern mode of procedure. If we were agreed that every new condition of equilibrium which arose in the normal way was the most appropriate solution even though many frictional losses and disagreeable phases had to be overcome en route, it would seem highly advisable to try to achieve this condition without delay and to reduce to zero the interim period which would otherwise slowly pass until a new and durable set of circumstances could be established – an interim period marked by hopeless struggle, by decline and by distress. That would be interference in precisely the

opposite direction to that in which we have hitherto proceeded, i. e. not contrary to the laws of the market but in conformity with them: not to maintain the old situation but to bring about a new one, not to delay the natural course of events but to accelerate it. With this in mind, our recommendation is for a form of liberal interventionism under the motto «fata volentem ducunt, nolentem trahunt».

I must refrain from citing concrete examples at this point not only because it would transcend the limits of my paper, but also because the quoting of individual examples nearly always generates a discussion about the concrete details which one ought to discuss in detail. Let me therefore simply give a short sketch of an example.

Assume that a certain delimited part of the farming sector was threatened by a loss in competitiveness due to protracted structural changes on the world market. Assume that it was then, in effect, largely ruined and that the authorities reacted in the customary way by attempting to offset the damage by custom tariffs, subsidies etc only to experience the usual failure. The position would grow steadily worse as more and more official measures were adopted.

If we then decided to emulate the Manchester school and simply let things take their course, the following condition would supervene after decades of distress and a desperate struggle to hold on to inherited plots of land. Those capable of adjustments would have carried them out accordingly: those not in a position to do so would have been forced to quit their plot of land and try elsewhere to find somewhere of permanence.

My proposal is that this final situation should be immediately established by accelerating and facilitating the potential adjustments by educational and financial aid and that those who cannot be helped in the position which they now occupy should be given another position in exchange where they will have a new, healthy and competitive basis for production. This form of intervention would cost only a fraction of what the other kind normally costs and which moreover continues for an unforeseeable period of time. In addition, this fraction of the costs would create a durable and sound situation whereas, under the system hitherto employed, the insupportable circumstances would merely be prolonged. Another point. It is a form of intervention which soon renders itself superfluous whilst the other form becomes all the more indispensable, the more often that it is used. In this respect, it resembles morphium: the more one wishes to achieve the same effect, the greater the dosage needed.

At this juncture, many an interventionist might observe with gratification and relief that, if a fanatical liberal like myself ventures on some kind of intervention, then it will surely no longer be difficult to reach agreement and the unresolved details can be settled as and when necessary. But that would be a big mistake. In effect, this involves a fundamental difference and a polarity marked by great tension if one does not consider things on the abstract plane but on that of dynamic reality. The position is not what a rational person may imagine it to be. The State does not reflect on whether and how it should intervene; it does not in practice have several options to choose from; it does not consider that it has unfortunately committed errors and, profiting from this new found wisdom, hope to do better in future. The fact that the State has hitherto intervened in this way and not in any other way results from very deep-seated and cogent factors. The new method of intervention which I have in mind presupposes the creation of a completely different State to the one which has hitherto been customary. It is not the same State which can take action in one direction or the other.

Let me make one fundamental observation at this stage. The view seems to hold sway today that the manifestation which *Carl Schmitt*, following in the footsteps of *Ernst Jünger*, called the «total State» (i. e. an overflowing of the State over its previous limits and the incorporation of all conceivable facets of life within its purview) now exemplifies the true strength of a nation. In reality, the opposite holds true: that is not state omnipotence, but state impotence. It embodies the State's most grievous weakness, a weakness which can no longer withstand the combined assaults of the interest groups. The State is being pulled apart

by greedy self-seekers. Each of them tears out a piece of the State's power for himself and exploits it for his own purposes. That explains the universality of the phenomenon. For it is not true that past governments merely distributed subsidies to their party adherents: all of them had to yield in all directions, quite often most of all in the diametrically opposite direction to their own, since it was from there that the most uninhibited and ruthless demands came. There is no need for me to provide any illustrations of this. But it furnishes proof that the Government and the State were not the subjective agent in these processes but the suffering object: the active agent was the interest groups. This phenomenon can best be described by a term used by *Carl Schmitt* – «pluralism». Indeed, it represents a pluralism of the worst possible kind. The motto for this mentality seems to be: the «role of the State as a suitable prey».

The opinion has been expressed on various occasions today that, if the practice of granting subsidies and of intervening yields such bad results, then this springs from lack of planning. All one needs to do consists in adjusting the plans for intervention and then matters will improve. But what I have said shows that a lack of planning is fundamental to the nature of the state interference hitherto practised. An intervention based on the premise that every interest group is entitled to help itself to a slice of the cake cannot be described as «planned». This State of ours does not enjoy the option of interfering according to a plan rather than haphazardly. It can only intervene pursuant to a uniform plan in one exceptional and marginal case i. e. when the struggle between the interest groups for the national assets end with one of them gaining the upper hand, driving the others from the field and annexing the State for itself. At that juncture, a single interest group which dominates the State on its own can of course look after its interests and pursue its goals on the basis of total planning. That is what has happened in Russia, where a few million industrial workmen (or people who were once labourers) are now ruling in tyrannical and autocratic fashion over a hundred million peasants, who in any case have been used to this treatment for many centuries. That constitutes the only form in which a planned economy has ever been realized in practice and, in my view, it is the only way which would be feasible. At this stage, we are not discussing the question of whether such a condition – in which the State does much better than under a division among many groups – should be deemed desirable in political, humane and everyday terms. At any rate, one has to be clear in one's mind about the absolute necessity of this political prerequisite when voicing the usual demands for a planned economy or proposing to the State that the interventions so far carried out in haphazard fashion should in future be effected methodically. In reply to this concept of a democratic planned economy such as *Carl Landauer* propagated, it should be pointed out either that it is an impossibility and a contradiction in terms or – if one wishes to inject a some what bitter remark – that a democratic planned economy is more or less precisely what we have already experienced and that it cannot in fact take on a much difference appearance to what it already has.

The Guiding Principles of the Liberal Programme

Wilhelm Röpke

1944

Even before the Second World War, the condition of our economic system had become untenable: after the War, it will be even more so. As has been seen whenever Government measures of any kind increase in scale and collectivism grows apace and the regimented sector of the economy expands at the expense of the free market, the critical point is sooner or later reached at which the remaining segment of the market system will fail to function.

That is the point at which a decision must be taken as to whether the regimented economy should be given the responsibility for the whole of trade and industry or whether it should be reduced to such an extent that the free-market sector can once more work efficiently. In other words, it is a point which does not permit a standstill. It was reached in Germany in 1936 and in France a little later under the Popular Front Government. Whereas Germany decided for political reasons to pursue a policy of full collectivism, we saw how France under the *Reynaud* government arrived at clear-cut conclusions and then set out to refloat the market economy by restraining collectivism. The United States thought they could afford to vacillate about the crucial point until wartime collectivism made it necessary to postpone a definite decision – as it did in all the other countries. But nobody should have any delusions about the fact that the moment will come on the first day of peace when an unequivocal decision will have to be taken. We must now start to prepare ourselves for that juncture by giving the matter a great deal of our close attention and by thinking out the various aspects of the problem as thoroughly as possible. It is now time for us to face the basic issues without hesitation.

We must begin with the uncompromising realization that those who reject collectivism must automatically favour a market economy. But a market economy implies freedom of the market, free prices and elastic costs: it implies adaptability, flexibility and the subordination of producers to the dominion of demand. In negative terms, it represents the exact opposite of monopoly or concentration and of the anarchy of interest groups now multiplying throughout the world like Penelope's suitors. Market economy implies repudiation of the

principles of collectivism and their replacement by the sole regulative principle at the disposal of our highly differentiated and highly mechanized society. But if this principle is to really guarantee a sound regulation of the economic process, it must remain pure and uncontaminated by monopolies. Only in that way can it become an «efficiency principle» and thus satisfy our sense of justice.

The organizing of the market economy as a genuine competitive system – that is the first clear line in the architectonic layout we shall have to draw up. In his famous message to Congress on 29 April 1938, *Roosevelt* announced that the fundamental aim of his Government's programme was to stop the advance of collectivism in economic life and to subject the economy once more to a democratic and competitive system. And just as there is hardly any level-headed person in the United States who would not accept this programme, so it has also become an indispensable guideline for the economic policies of other countries. It is no mere coincidence that the voices proclaiming this with special urgency come from collectivist countries. This guideline also permits us to recognize as an incomprehensible blunder such attempts which, consciously or unconsciously, aid and abet the increasingly monopolistic paralysis of economic life now taking place under the seductive banner of a misconceived corporativism. Proposals of that kind recommend a highly peculiar remedy against a degeneration of the market economy – a degeneration characterized by increasing market rigidity and group anarchy.

As we finally outline the direction to be taken, there is, we hope, no need to tell anyone that we have no intention of hoisting the old moth-eaten flag of capitalism. If anyone of you should assume that, then all I say is that my writings and teachings of the last ten years have been in vain. As for the rest of my readers, I wish to limit my observations to the following points.

To begin with, we should recall that «capitalism» is nothing more than the burnt-out and rotten form which market economy has assumed during the last hundred years of our industrial history. A genuine free market and system of competition represent something which «capitalism» never really was – at least not during the last 50 years. To that extent, then, our programme is thoroughly «anti-capitalist». Moreover, this is something which the advocates of the status quo understand. Thus, our first guideline – genuine competition – is not conservative in character, but entirely revolutionary. It is a truly anti-monopolistic policy of the most genuine and radical kind, keen to abolish monopolies rather than simply tolerate and supervise them.

But we reject the principle of *laissez-faire* just as categorically as we spurn monopolistic capitalism and gigantism. That brings us to the second point. A practicable and satisfactory market economy cannot emerge from systematic inactivity. Such an economy is rather an artificial structure and a product of civilization: what it has in common with a political democracy, is that it is particularly difficult and demanding. That is why we must undertake such strenuous efforts to attain it. The outcome of this is a comprehensive programme of positive economic policies with an impressive catalogue of objectives. These fall into two main groups.

The first group consists of measures and institutions which impart to competition the framework, rules, and machinery of impartial supervision which a competitive system needs as much as any game or match if it is not to degenerate into a vulgar brawl. A genuine, equitable and smoothly functioning competitive system cannot in fact survive without a judicious legal and moral framework and without regular supervision of the conditions under which competition can take place pursuant to real efficiency principles. This presupposes mature economic discernment on the part of all responsible bodies and individuals and a strong impartial State – and, I mean to say, strong and not merely busy. As *Benjamin Constant* once aptly remarked: «Le gouvernement en dehors de sa sphère ne doit avoir aucun pouvoir; dans sa sphère, il ne saurait en avoir trop.»

Whereas this series of measures relates to the framework of market economy, the other

group, in contrast to the philosophy of laissez-faire, concerns the progression of judicious, well-regulated and well-balanced governmental measures in support of a framed and supervised economy. The first set of measures – which we can call framework – leaves the market economy free to operate within this framework whilst the second group represents real interference with the freedom of the market itself and may therefore be designated as market policy. Hence, we subscribe to the view that it would merely constitute one more example of the much censured stubborn adherence to an absolute and unconditional scale of values if one were to deny the need for a certain degree of government interference under a market-economy system. Admittedly, we must immediately be on our guard so as not to become disloyal to the free-market system and not to issue a general warrant for an unprincipled interventionism which may then degenerate into a policy of collectivism. We require specific principles in order to accentuate the form of interventionism known as liberal interventionism (*A. Rüstow*) and in this way to establish guidelines for a rational economic policy to which the statesman can adhere in practice when he does not wish to navigate without a compass.

Here, again, there are two main principles on which such a liberal interventionism would have to rest.

The first of these principles is derived from the distinction drawn between maintenance subsidies and adaptation grants. We reject the former as reactionary, dangerous, and irrational, but advocate the latter in order to mitigate the hardships and frictions of adjustments and disturbances in economic life and to help the weaker social groups in their struggle to survive. In this way, we do equal justice to the aims of the market economy and the dictates of rationality and humanity. We ought to become even more explicit and to leave no-one in doubt about our view that certain sectors of economic life such as agriculture, handicrafts, small businesses, and also manual and white-collar workers are particularly weak and vulnerable. They fundamentally deserve special assistance.

The second principle underlying our liberal interventionism derives from another distinction presumed to be known to all, yet not fully understood by non-economists. I refer to the difference between official measures in conformity with the market and those not in conformity with it. Their significance rests on the need to construct a firm dam against such Government action as must be averted at all costs if we are not to slide into collectivism. We must be quite clear in our minds in regard to official measures whether they are still in accord with the principles of our market-economy system and are absorbed by the latter or whether that is no longer the case. We must be able to distinguish between the two with the same degree of certainty as we possess in telling the difference between methyl and ethyl alcohol when we want to indulge in an alcoholic beverage. The distinction between conforming and non-conforming measures serves to fulfil this indispensable clear-cut aim and no other, and I do not know why this very simple definition should give cause for argument or criticism. Admittedly, it is self-evident that the conformist character of a governmental measure by no means suffices in itself as a recommendation, just as the distinction between methyl and ethyl alcohol by no means involves a recommendation to become a drunkard. Conformity merely represents a necessary – although not an adequate – condition for taking official action. It denotes the appropriate instrument and not the aim itself.

In other words, the distinction in question merely signifies that, if we decide upon the adoption of official measures, those in conformity with market trends deserve preference over non-conforming ones, inasmuch as we do not wish our interventionism to change into collectivism. Whether the measure in question is actually implemented and which form it should take depends on other considerations. Naturally, there are official measures in conformity with the market such as high protective tariffs which must be condemned as highly detrimental. However, we must add that it would be even more detrimental if the same safeguards were to be enforced by non-conforming economic policies such as foreign exchange controls or import quotas . . . That brings us to the end of the second main point of

our programme, which is marked above all by a positive economic policy and opposition to the principle of laissez-faire . . .

Let us now turn to our third guideline and one with which we depart appreciably from economic policy in the restricted and traditional sense of the term. Let us turn to a policy which could be called structural policy, since it refuses to regard the social preconditions of market economy as self-evident but wishes to change them for a special purpose. (By the expression «social preconditions of market economy», we mean the distribution of income and property, the size of the enterprise in question and the pattern of population between town and country, industry and farming and between the social classes). When we grant such a policy an important or even an outstanding place in our programme, the name that suggests itself for our official support measures is that of «economic humanism». But it should not be overlooked that this policy is closely linked to the two guidelines mentioned above.

By speaking up on behalf of a genuine market economy directed against monopolism, concentration and capitalist gigantism and on behalf of a positive economic policy inspired by common-sense and humanity and on behalf of a mitigation of hardships and conflicts to protect the weak, we have already decided by virtue of that action in favour of the small and medium-sized firms in all sectors of the economy. We favour everything done in moderation, the quiet approach, measurable and man-sized dimensions, the middle classes, the re-establishment of property ownership among as wide a section of the population as possible, and of a policy of deproletarianization and economic decentralization.

That is the third guideline for our policy. Yet these three guidelines in themselves do not make up the whole programme. On the contrary, we have still to erect the fundamental foundations or at least those foundations which will give our whole layout its decisive form. What we have to be sure of is the following: despite the extensive nature of all the economic reforms which we have so far named, we have nevertheless still largely remained within the narrow province of economic policy – however much we may have transcended its limits with the last named point about economic and social decentralization. So far, we have been thinking principally in our capacity as economists. But now our task is to think as sociologists and social philosophers. Hitherto, our pursuit has largely been economic policy: now it must become social policy. This appears to be such an unusual and seemingly bold step that it does not surprise us to hear that some of our fellow economists still find it difficult to follow us along this particular path. But we must not get discouraged and redouble our efforts to convince them.

It was the cardinal mistake of the old liberal «capitalist» way of thinking and acting to regard the market economy as a self-contained and automatically operating process. It had been overlooked that a free market only accounts for a narrow segment of social life within a broader external framework in which people are not competitors, producers, businessmen, consumers, trade unionists, shareholders, savers, and investors but quite ordinary people who do not live on bread alone: family members, neighbours, church-goers, colleagues, fellow-citizens and real people in the flesh with their eternal human thoughts and sentiments about justice, honour, helpfulness, public spirit, peace, an honest day's work, beauty, and a love of nature. A market economy is merely a specific, albeit indispensable scheme of things within the narrowly prescribed sector where it belongs – at full strength and in unadulterated form. If left to itself, a market economy is dangerous and indefensible because it reduces people to a thoroughly unnatural existence which they then cast aside together with the free market which has become hateful. In other words, the market economy requires a firm framework, which we may conveniently refer to in short as the anthropological-sociological framework. If this framework breaks down, then it is no longer possible to have a free market. In other words, market economy is not everything. It has its special place in a healthy and efficient society where it is indispensable and where it must remain pure and undiluted. But it is doomed to rot and infect all the other sectors of society with its

putrefaction unless complemented by other sectors, a field of self-sufficiency, a sound public economy, good planning, altruism, and simple non-materialistic humanity.

The principle of individuality under a market-economy system must be balanced by the principle of social justice and humanity if they are both to survive in our modern society and if the lethal dangers of mass levelling and proletarianization are to be banished.

[. . .] A free economy based chiefly on a free market, competition, private enterprise, freely fluctuating prices, and free choice of consumption will, in the long run, indeed prove impossible in a collectivist, proletarianized, uprooted, and unstable mass society. Our concept of a free-market system can be compared, in sociological and moral terms, with a hollow space in need of a particularly strong perimeter. It was the decay in these perimeters which in the past ruined both liberal economies and liberal social systems. From all this results the compelling conclusion for the remedial programme: the re-integration of market economy (and thus avoiding the danger of collectivism) is possible only if linked to a process of individualizing society, of deproletarianization, decollectivization, ruralization, and decentralization, i. e. linked to a social policy meant to establish an anthropological and sociological framework of greater stability.

[. . .] For the sake of a clearer conspectus, we have set out below the main outlines of the suggested economic and social reforms:

- I. Establishment of a genuine competitive system (an anti-monopolistic policy);
- II. A positive economic policy (anti-laissez-faire)
 1. Framework policy,
 2. Market policy (liberal interventionism)
 - a. Adaptation grants versus maintenance subsidies,
 - b. Conforming intervention versus non-conforming intervention;
- III. Economic-social structural policy (equilibrium, decentralization, «economic humanism»);
- IV. Social policy.

The Splendor and Misery of the Full Employment Policy

Fritz W. Meyer

1967

As we look back over a protracted period of full employment and even over-employment in West Germany and other economically advanced countries, it hardly seems possible to us today that only a few decades ago professional economists and economic policy-makers accepted the periodical bouts of under-employment throughout trade and industry during crises and depressions as a more or less inescapable evil. Some people even thought of them as a salutary experience, likely to promote the advance of the economy. In those days, it was not unusual to speak of the «cleansing properties of a crisis». A good illustration of this mentality among the experts was a famous article entitled «crises» by *Arthur Spiethoff* in the fourth edition of the *Handwörterbuch der Staatswissenschaften* (1923). In this article, which summarized the findings of the author's lifetime of research, *Spiethoff* explained more than just the characteristics and causes of crises. He also considered the «alternating phases of the economy» – meaning, of course, the trade cycle as a whole. However, *Spiethoff* chose not to go into the related question of finding a cure for cyclical decline and depression. This comes as no surprise when one considers how much importance *Spiethoff* attached to the ups and downs of the business cycle in the concluding part of his essay. In his view, not only the upswing with its full utilization of human and material resources and the surging expansion of production served to promote economic progress (marked as it is in this period of the economic cycle by a manifest increase in affluence), but also a recession i. e. depression or even a crisis. *Spiethoff* had the following to say about the period of under-employment:

«For the individual, this is undoubtedly in the main a time of suffering. But for the economy as a whole, it provides special benefits. There are in particular two such benefits: one of them based on the appropriate conclusions from the last expansive phase and the other preparing the next upturn.

In the case of cost-reducing inventions, a distinction must be drawn between the time when they first appear (or, with new plants, when they come on stream) and the time when they really start to dominate the market. Many such innovations, marketed during the

expansive phase, are not widely distributed because the keen demand together with high and rising prices do not necessarily result in the most advantageous units of production. Indeed, they permit the retention of older equipment. The upswing manages to keep going, in part, with old techniques. But that is impossible during the recessive phase; and low prices render it imperative to use optimal production units. Where losses loom or actually occur, entrepreneurs struggle to cut costs to the utmost. Even the sluggards and the stragglers have to join in this economy drive. Hence, this stagnation phase leads to an optimal updating of manufacturing facilities. Many individual steps are taken in order to improve the organisation of the firms and its technical equipment. In the struggle to survive, firms must fight hard and with perseverance every day of the week to wrest the maximum possible from a reluctant market. During the recessive phase, any large-scale innovations characterized by uncertain prospects are not marketed because entrepreneurs lack the requisite degree of boldness. On the other hand, when beset by a recession they contrive with great skill to squeeze the utmost benefit from their available facilities and thus to carry out a task for which they could perhaps find no time during the boom period.

A recession also provides fertile soil for another fine product – this time of an intellectual or even spiritual character. Sheer necessity inspires the more imaginative minds to enter upon a feverish round of activities designed to bring about better conditions. The upturn then comes from certain major trigger effects – whether these be technical innovations or the activities of highly individual enterprises or the exploitation of new markets. These trigger effects are a consequence of the recessive interval. They are not an incidental product of the recession: they stem from a deliberate and energetically pursued course of action. The implementation of this is a task for the upward phase of the business cycle, but it nevertheless represents a great intellectual legacy bequeathed by the recession. The upswing owes its origin to a thousand felicitous ideas and plans».

Spiethoff expressed these views after carrying out a large number of empirical observations, and his concluding judgment was as follows: «How does the fluctuation between boom and recession affect economic life? It forms the strongest means that could have been conceived for squeezing the maximum economic effort out of man that he is capable of. During the upward movement, there is the carrot and during the downward movement, the stick. What could be more effective than that?»

Spiethoff's concept of depression and crisis as an essential component in a highly effective recipe for growth was undoubtedly an extreme view with which he tried in positivistic fashion to make a virtue of necessity. But until the First World War and to a certain extent afterwards, a mood of resignation unmistakably prevailed about temporary and even longer-term deflation and underemployment. This fact not only provoked bitter censure from marxist Socialism about the capitalist economic system and its ostensibly inherent incapacity to master the crisis problem. It was also reflected in the popular economic writings of the times when the proposed steps to cure the crisis mainly consisted in palliatives such as unemployment benefits, better job vacancy registration and emergency jobs.

The largely passive attitude to the problem of underemployment was hardly (or only secondarily) a consequence of the lack of insight into the opportunities for an active and effective trade-cycle policy. Admittedly, the teachings of a man like *Silvio Gesell* (1862–1930) – who, even before the turn of the century, had developed the idea of constantly depreciating money and suggested stimulating overall economic demand by a continuous flight into material (non-monetary) assets – failed to attract serious attention, because his prescriptions were tainted with the blemish of inflationism. *Gesell* became a rank outsider. Even *John Maynard Keynes*, who wrote warm words of posthumous praise about his pioneer role in his «General Theory of Employment, Interest and Money» (1935), considered him to be somewhat eccentric until his later intellectual alignment with these views in his own doctrine of full employment. On the other hand, the Swede *Knut Wicksell* wrote one of the outstanding books and perhaps even the most important text on political economy of

the last hundred years. His work «Interest and Prices» (1898) replaced the simplifying quantity theory of money with an explanation of changes in monetary value and this led to the foundation of the modern theory of money and credit. Wicksell was the first man to contradict the prevailing view that money is merely a «multiplicative factor» in the sense that a specific change in the money supply leads to a corresponding alteration of the value of money with reversed premises. Wicksell argued that money constitutes a factor whose changes trigger dynamic processes in economic life. He also made the clear point that an interest rate on money below the marginal productivity of capital, i. e. below the «natural rate of interest» (as he termed it) leads to stimulation of investment activity and, in line with an increasing availment of productive resources, to a cumulative process of price increases. Unintentionally, Wicksell's monetary theory had a by-product: it created the intellectual foundations for an active trade-cycle or employment policy. It should be emphasized that Wicksell was not the least interested in having his ideas exploited to promote a doctrine of full employment. As a convinced adherent of the ideal of price stability, his goal consisted in pinpointing the causes of currency erosion in order to be in a position to prevent inflation – but certainly not in processing them for the sake of full employment.

There are good reasons for doubting whether, and to what extent, Wicksell's contemporaries understood the implications of his theories for anticyclical treatment. On the other hand, the indispensable prerequisites for the application of such a therapy were simply non-existent prior to World War I. The then prevailing international currency system, the traditional gold standard, narrowly circumscribed the autonomy of national credit policy. The governors of the central banks had to base their credit policy decisions (which brought about changes in the interest rate on money) upon fluctuations in the volume of gold reserves held by their banks, and certainly not upon any requirements enunciated under trade policy or employment policy. The strict provisions on covering bank-notes by gold-reserves permitted a policy of credit expansion in the event of an influx of gold, and the central banks usually grasped this opportunity in their own commercial interest. But it was virtually a matter of luck whether this expansion or the opposite policy of credit contraction – strictly stipulated in the event of an outflow of gold and a cover shortage in the circulation of bank notes – was carried out at the right moment in terms of trade policy or employment policy.

After World War I, Governments thought they could have their cake and eat it: they wanted to add to the principle of stable exchange rates under the gold standard an expanded scope for implementing credit policy in order to improve opportunities under a national trade cycle policy. To this end, a number of countries endeavoured with varying degrees of success to achieve a gold coverage for bank note circulation over and beyond the statutory provisions so as to curb, in the event of an outflow of currency reserves, a cyclically undesirable contraction of credit or to permit an advisable expansion of credit even without any influx of gold and foreign currency used as cover. As this move did not accord at all with stable exchange rates and exchange convertibility, it was doomed to play a major role in the collapse of the gold standard. Excess cover for the circulation of bank notes can only be provided where no use is made of the scope for credit expansion inherent in an accrual of foreign currency reserves. However, this «sterilization» of accruals of monetary reserves produces the following situation. Of the two instruments in the normal mechanism for squaring the balance of payments under the gold standard designed to bring about the requisite readaptation of balances on current account (i. e. credit contraction to offset the efflux of foreign exchange reserves and credit expansion to counter an inflow), the device for credit expansion is largely or indeed completely eliminated. In such circumstances, distortions in the balance-of-payments equilibrium can only be rectified unilaterally by major and protracted outflows of foreign exchange reserves and by an appropriately tough bout of deflation in the debtor countries.

The system failed to withstand the severe test to which the emasculated gold standard was

exposed after the flouting of the rules when huge transfers took place as from 1929 because of the repayment of external debts. As the principal creditor nations not only sterilized the accruing gold but also espoused a competitive deflationary policy in order to counteract growing competition on export markets from debtor nations forced into such a deflationary policy, the worldwide deflation crisis worsened to the point of generating intolerable consequences. The currency devaluations and the move towards foreign exchange controls brought about the abandonment of the gold standard and the establishment of autonomy in national credit policies – an indispensable prerequisite for an active anticyclical full employment policy. By the same token, the painful experience of the unparalleled degree of under-employment during the world economic crisis and in particular the mass unemployment made the attainment of full employment a major goal of economic policy.

The first great and in the short run successful experiment deliberately undertaken to achieve full employment – and one which attracted the admiration of other countries – was started in Germany in the Summer of 1932 when *Herr von Papen's* Government abandoned its deflationary measures in favour of an active anticyclical policy. After the National Socialists had seized power, they spent large sums in continuing this campaign on a larger scale and made strenuous efforts to depict this anticyclical policy and above all the formula for creating employment as their own invention. Even today, this experiment of the Thirties stands as conclusive evidence that the achievement of full employment in practice is perfectly consistent with relatively stable prices. However, one might differ on the empirical value of such evidence and on the wisdom of the measures adopted at the time in order to stimulate the economy. Be that as it may, there is no denying that the failure to devalue the reichsmark (despite the substantial devaluation of the pound in the Autumn of 1931 throughout the sterling area and that of the dollar and other currencies at a later stage) significantly reduced the competitiveness of German exports. By virtue of this substantial revaluation or over-valuation in relative terms of the reichsmark – estimated by the American expert *H. S. Ellis* at 45 to 75% in terms of sterling – the policy-makers in Germany bent upon the implementation of an active anticyclical policy forfeited the opportunity of an export boom large enough to stimulate, or even to spearhead the economy. The value of German exports in terms of the then valid prices actually fell between 1931 and 1934 from RM 9,600 million to RM 4,200 million. As on the other hand the revival of the German economy generated a rapid rise in imports, the objectively unjustifiable retention of the old gold parity produced a worsening of the German balance-of-payments crisis. The exchange controls already enacted in the Summer of 1931 to regulate the reflux of capital from Germany, but unproductive of any appreciable restraints on the purchase of goods and services from abroad to begin with, now had to be extended to imports. The admissible basic exchange quotas were allocated under the system of «general licences» to import firms as a percentage of their imports expenditure during a former period of reference. The importers could use them mainly without further restrictions in respect of various categories of goods and supplying countries. These quotas were continuously cut from their level of 50% in May 1932 until they had fallen to 2.5% by June 1934. This limitation of imports, linked to a simultaneous rising demand for imported goods, created the danger of an upsurge in prices caused by the cost of such imports. However, this danger was counteracted by means of a price freeze on imported articles.

Contrary to widespread belief, the threat to stable prices flowing from the policy of full employment did not arise during the German experiment in the course of 1936 when the unemployment rate of only 5% corresponded, in the then held view, to a full commitment of the available manpower and material resources. In consequence of this reduction in unemployment, a general price freeze was announced on 26 November 1936 and backdated to 17 October 1936. As regards wages, these had been frozen as early as 1933. In other words, the policy of full employment on the basis of a completely unrealistic exchange rate had already gravely jeopardized price stability due to bottlenecks in the supply of imported

goods at least two years earlier, i. e. in 1934, when the unemployment rate reached 13% by the middle of the year. These dangers were aggravated by the use of substitutes for the missing imported goods, a step which tended to increase prices because these ersatz products were manufactured within Germany at a higher cost as part of the quest for autarky.

According to the official cost-of-living index, the wage freeze of 1933 and the wider-ranging price controls in operation between 1934 and the complete price freeze of 1936 crowned with success the efforts to obtain price stability by repression and controls. During the six years from 1933 to 1939, this index (1913/14 = 100) only rose from 118.0 to 126.2, that is to say by just over 1% per year. Nevertheless, one is justified in entertaining misgivings about this figure. True, the absence of explicit proof to the contrary thwarts any claims that this astonishing result came about through deliberate statistical manipulations. On the other hand, there can be no doubt that the actual extent of the inflation during the German experiment in full employment was substantially understated in the cost-of-living index. The prices did not reflect, for example, the large-scale deterioration in the quality of goods caused inter alia by the exacting provision to grind more flour out of a given quantity of wheat etc., provisions for cereals, the dilution of butter, the compulsory addition of certain substances to textiles, the ban on the use of non-ferrous metals etc. It should also be borne in mind that many inexpensive goods were no longer obtainable or at least not in the desired quantities due to import restrictions, the increasing scale of controls or the tendency of suppliers to offer the more expensive qualities as a result of the provisions on pricing and the lack of raw materials. Since these conditions forced consumers to concentrate their demand on less durable, less useful and also more expensive products, the purchasing power of their incomes actually sank far more than indicated in the official price index. Hence, it remains a very doubtful claim that the policy of full employment pursued during the German experiment before World War II actually succeeded in keeping inflation within manageable proportions. Yet even this presentational, albeit ineffectual price stability was obtained at too high a price because of the rapid transition – attendant upon the price freeze – from a market economy with free price-setting and an optimal use of productive resources to a dirigistic economy involving direct controls on production, manpower and consumption. Moreover, it was marked by a peculiar form of organized diseconomy tantamount to a squandering of productive resources.

The second German experiment in full employment is one which we have experienced personally in the Federal Republic and which differed in many aspects from the Thirties. Following the Currency Reform of 1948 and the processing of the legacy of the first experiment with its accumulated inflation in the form of a surplus money supply, the important thing was to rebuild the productive apparatus and to integrate within the labour force the swollen population of the Western part of Germany consequent upon the influx of refugees and expellees. The fact that we achieved this goal fairly quickly and – at least until well into the second half of the Fifties – with a relatively modest level of inflation resulted not only from the great elasticity of supply but also above all from a circumstance which we first of all considered to be a discrimination against the West German economy. During the spate of currency devaluations triggered by the devaluing of the pound in September 1949, a decision had to be taken on the size of the devaluation for the German Mark. This decision lay with the Allies, who opted for the modest devaluation rate of only 20.6%, whereas the other major world trading partners usually decided upon 30% or even 33.4% in the case of Great Britain. Such a devaluation rate entailed a relative revaluation of the German Mark vis-à-vis most of the other currencies. The main worry behind this step had been that a larger devaluation would have caused a flood of price increases in West Germany due to dearer imports. Although the decision represented a manifest discrimination against exports from West Germany, which in any case still stood in the initial phase of its great reconstruction efforts, it nevertheless produced the following beneficial effect. In its endeavours to reduce foreign exchange controls by increasing exports – a move which it was compelled to make as

a result of bold action on liberalization – West Germany was left with the sole possibility of increasing exports to its major trading partners by improved price stability. Hence, the lack of foreign exchange during the first years after the Currency Reform forced West Germany to pursue an employment policy calculated to weaken price stability as little as possible. Neither economic growth nor the ideal of high employment were neglected under this economic policy. Unlike the present time, that policy could then be honestly described as according equal status to the two objectives within the framework of a market-economy system. The high rates of economic growth in West Germany were recorded during this period of modest inflation. And despite a continuous substantial increase in the labour force due to the arrival of refugees, the unemployment ratio fell from 7.3% in 1950 to 3.8% in 1955. During these years, the number of employed persons rose every year by an average total of 670,000.

After the reorganization of the international monetary system at Bretton Woods, the resulting convertibility of currencies meant that the – by international standards – very modest inflation rate in the Federal Republic of Germany could not be maintained in the long run. The introduction of currency convertibility in a system of fixed exchange rates cannot fail to produce a situation where the average currency erosion rate will inevitably also assert itself in those countries bent upon preserving price stability more successfully than their neighbours. As the demand in countries with a relatively strong growth rate for overall demand seeks out the most favourable markets, the countries with stable prices or low inflation rates are infected by the prevailing inflationary trends. This takes place via direct price contacts in internationally traded goods and services and via accruals of currency reserves with the resultant impact of increased liquidity on the bank system. In this way, those countries participating in the system are synchronized with each other, not only in the development of their price level but also in the priorities of economic policy. If the goals of full or over-employment and of economic growth normally take precedence over that of price stability – and that is unequivocally the case in most countries – a quest for equal priority among aims or for greater priority in respect of price stability cannot be successful in only one country or in a minority of countries. The only way out of this complication in the system – i. e. assuming that one wishes to retain it – consists in corrective adjustments of the exchange rates as envisaged by the statutes of the International Monetary Fund. As West Germany availed itself of this possibility on much too small a scale and moved much too late in its revaluation of the German Mark in 1961, it was impelled by the adjustment process accompanying the protracted and massive influx of currency reserves from full employment into over-employment and from the role of a non-inflationary laggard into that of an inflationary pace-maker. The consequences of this shift in direction revealed themselves in the balance of payments. By 1964, the influx of monetary reserves had dried up and the Central Bank's foreign assets dropped by about DM 3,000 million during 1965 and the first quarter of 1966. Unlike the German Government, the Bundesbank reacted to this signal and to the substantial acceleration in inflation within its sphere of influence. However, opinions were divided about the advisability of introducing the Coupon Tax Law by the Federal Government, backed though it was by the Federal Bank in order to guard the economy against external influences by means of a tougher credit policy.

Despite the atmosphere of artificial and intended pessimism about the efficacy of high interest rates eagerly disseminated by the adherents of cheap money, over-employment and forced growth, the modest application of the traditional instruments of credit control by the Bundesbank reversed the decline in currency reserves during the remaining months of 1966 and mitigated the overheating of the economy. Nevertheless, the pace of creeping inflation did not slacken in 1966. The slight decline in the cost-of-living index from its highest level of 113.3 (1962 = 100) in the months of May to July 1966 to 0.5% less in the Autumn stemmed solely from a reduction in the prices of seasonal foodstuffs. Despite the cooling of the economy, all other prices continued to rise without delay so that the Council of Experts for

Assessing Macroeconomic Trends noted in its annual report for 1966/67 that prices had risen faster than in any year since the Korean crisis.

As we now know, the concomitants of the second German experiment in full employment were not much more encouraging than those of the active cyclical policy in the Thirties when the price-freeze merely masked the currency erosion without effectively preventing it. At the same time, the freeze made direct economic regulation unavoidable. Admittedly, the renunciation of direct price controls helped to preserve the West German market-economy system. However, the objective of price stability has finally been sacrificed in favour of full employment. Must this be so? Is it really correct to allege – as frequently happens – that we only have the option between two evils, an inadequate level of employment on the one hand or inflation on the other? And that we shall have to accustom ourselves to a life of creeping inflation because of the sheer impossibility of renouncing a high level of employment? Is currency erosion the inevitable price of full employment under a free economic system?

Despite the negative experience made during the German pre-war experiment, the inevitability of this high price was still in dispute after World War II. One of the Anglo-Saxon apologists for full employment at all costs and a man who tried at the time to offer us his prescription in scientific wrapping, *Lord Beveridge*, voiced a somewhat naive view derived from oversimplified thinking in terms of global quantities. He felt that effective overall demand could be expanded without inflationary consequences as long as unused manpower and material resources were still available in the economy. During a public discussion of these questions held in Kiel shortly after the war, he illustrated this view with the observation that a bicycle-tyre had to be pumped up to the right pressure, i. e. neither too much nor too little. Needless to say, this dangerously simplistic doctrine is untenable. Where effective demand increases in an underemployed economy, then sooner or later (e. g. after completion of the period of «quantity boom») there occur shortages or bottlenecks in certain sectors of production beset by a lack of manpower or resources, whilst other sectors are still suffering under-employment. It is theoretically possible but wholly improbable in practice that idle productive resources occur exactly in the ideal blend in which they are absorbed by growing demand. The trend towards price rises in the bottleneck sectors becomes all the weaker, the more efficiently the international division of labour ensures by dint of currency convertibility and modest trade restraints that supplies in the bottleneck sectors can be increased by means of imports. If and when such stabilizing imports prove successful – and hitherto this has presupposed unused capacities in the appropriate sectors of the supplying countries – then another bottleneck will arise all the more quickly in the shape of a difficult balance-of-payments situation. If the experiment of pursuing a policy of full employment is to be continued out of consideration for the underemployment persisting outside of the bottleneck sectors, then either the currency has to be devalued or foreign exchange controls introduced in order to gain scope for a further expansion in demand. In both cases, the rise in prices continues – aggravated by the shortages i. e. the rise in the price of imported goods. It may also happen (and this is very probable under the prevailing conditions) that imports for overcoming the bottlenecks are only possible at rising prices and in lower quantities due to the simultaneous expansion in demand abroad. In such a case, the tendency in our country for prices to rise in conformity with the degree of expansion in demand at home and abroad will not be curbed or to a small extent only. In effect, it may even accelerate because one's own exports also expand under a universal expansion in demand. This in turn decreases, eliminates or reverses the danger of balance-of-payments difficulties in favour of an undisturbed continuation of demand expansion in one's own country. On the other hand, the growth in one's own exports with its tendency to promote full employment but also to export stability leads to price rises at home on a wider scale.

As even a little thought will indicate beyond doubt, inflation does not simply arise from a policy of full employment when this policy continues beyond the point of time when the available manpower and material resources are being fully utilized. In view of the conditions

which exist in reality, inflation will in any case make its appearance prior to that. Its impact will be all the stronger, the greater the impatience shown in the spacing of demand-pull expansion in the interest of as expeditious an attainment of full employment as possible. In this case, insufficient time is allowed for the adjustment operations in supplies in the bottleneck sectors – initiated by changes in the price system – in order to increase capacities. This overhasty full-employment policy even brings into existence a situation where productive resources are continuously exploited for economically less beneficial purposes at the expense of optimal use, i. e. potential growth.

But the hazards of full employment for price stability not only consist in the above-described shortages. An equally serious danger flows from the exaggerated euphoria engendered among entrepreneurs and trade union officials in regard to prices, wages and investments following a proclamation of the goal of full employment. As soon as entrepreneurs and trade unionists are given a guarantee of full employment, they can be sure that the call for, and authorization of excessive wages will at worst result in a temporary loss of jobs. But even that does not occur as a rule, because it proves easy in practice on account of the expansion in demand from wage increases to pass on rising costs to prices within the framework of an elastic supply of credit. As soon as we have accustomed ourselves to the operation of creeping inflation and come to expect it to continue unimpaired, then the future currency erosion preempted by the decisions on prices and wages will in fact actually take place. As events in West Germany have shown, the process of inflation becomes more and more autonomous as full employment and over-employment are achieved. The general rise in prices only reveals a slight measure of dependence on shifts in the degree to which capacity is utilized in trade and industry. However, that stems not only from anticipated prices but also from international influences and from wage lags. Since the wage increases granted during boom conditions in line with greater productivity do not influence demand until the later downward phase, they prevent any slowdown in inflation and stimulate trade and industry anew. During these times of full or over-employment the trade cycle itself, formerly an alternation between upswing and price increases on the one hand and depression and deflation on the other, has been shifted – as it were – towards the ceiling of the economic possibilities, cyclically reaching this upper limit according to boom or recession. As regards the trend in currency depreciation, there is no longer any significant difference between the phases of the trade cycle.

For years, the Bundesbank proved to be impotent in the field of credit policy because of its deliberate but misguided insistence on retaining an unrealistic exchange rate, which failed to reflect the true value of the German Mark. Since 1965, however, the conditions surrounding the efflux of currency reserves have been favourable for a successful application of its instruments and the Bank has in fact made considerable efforts to restrain overall demand. But before the federal budget was put in order or the fruits of the Bundesbank's efforts to restore price stability or a lasting approximation to this condition had matured, there presented itself a call for a relaxing of the restraints on loans in the interest of full employment and growth. Apparently, the new Federal Government believes it can wash the fur of creeping inflation without getting it wet. Its intention is to master the problem of linking relative price stability with a high degree of full employment and renewed growth – a problem hitherto unresolved in economic practice – and to initiate a voluntary system of «Concerted Action» in order to achieve this. Whether or not the German Government had dirigistic controls in mind when it first announced this programme is still an open question. It may be assumed that the «Concerted Action» will endeavour to translate into practice the ideas developed by the government-appointed Council of Experts in its last two annual reports in conjunction with the wage provisions set out in the reports for 1964/65. In essence, these state that, as progress is made towards the goal of price stability, wages must not be raised more than in line with the expected and adjusted overall advance in productivity plus the provisionally tolerated rate of inflation. As employees cannot be expected to make

these sacrifices unless they are matched by the envisaged degree of price stability, a whole series of further measures must be implemented in order to safeguard the acceptable rate of currency depreciation. The Federal Government and the public authorities acting together with the Bundesbank and the whole of the bank system ought to ensure that public expenditure and private investment remain within the framework corresponding in the first instance to the permitted inflation rate. Only that method can ensure that the cost-push inflation precluded by the operation of wage rules is not replaced by a demand-push inflation with a consequent wage drift when actual wages rise above the level corresponding to the rules on wages. Under the Concerted Action, it is not only the regulation of public expenditure which renders it necessary to introduce new instruments. In a case of need, the restricting of the scale of private investment should also be safeguarded and this not only via official credit policy but also via fiscal measures for curbing or stimulating the propensity to invest. It seems almost self-evident that internal stability policy must be protected against external influences. To this end, the opportunities for a graduated flexibility in exchange rates provided in the statutes of the International Monetary Fund are manifestly inadequate.

The Council of Experts has made it quite plain that all the above conditions – which we have only sketched in incomplete form – imposed upon the public authorities, the Bundesbank and the commercial banks, management and labour must be fulfilled within narrow limits if the drive to overcome the contradiction between the aims of price stability on the one hand and full employment and growth on the other is to prove successful. But does it seem possible? Or do not the conditions surrounding the Concerted Action overstrain the capabilities of the Government and the administrative authorities every bit as much as they do the altruism of enterprises with commanding market positions or of individual trade unions with hopes of unilateral advantages if they break ranks? For the sake of its great goal and above all of price stability, it is to be hoped that the efforts undertaken by the Concerted Action will produce the desired results. However, the difficulties of implementing these ideas are immense. They begin with the by no means certain approval which every individual trade union has to give. Another problem arises in connection with the reliability of the prediction about greater productivity, upon which the wage provisions are to be based. If this is overestimated and it cannot be revised during the term of the collective wage agreements, then the result is a pressure on costs to which credit policy has to bow or face a fall in employment and growth. If credit restrictions are relaxed and the planned rates of price rises exceeded, employees will feel duped even though their wages in real terms are no lower because of the unforeseen price rises than they would have been in the event of a correct forecast on the advance in productivity. Can the effects of fiscal measures for supplementing the regulation of investment volume by means of credit restraints be assessed with any degree of certainty? Will the Bundesbank surrender its hard line on the inviolability of exchange-rate stability in favour of safeguarding the economy against external influences? The list could be extended to include numerous individual items, but the main problem remains whether or not our free market economy itself could become a victim of the Concerted Action if the promising start under the influence and political prestige of outstanding public figures is followed by a period of difficulties which can allegedly only be counteracted by dirigistic measures because of lack of time or certain other reasons? The Council of Experts has drawn attention to such a danger i. e. the application of Article 23 of the Foreign Trade and Payments Law, permitting a limitation of imported capital in all possible forms. If by-passing operations are to be ruled out, a direct prohibition of undesirable imports of capital would be tantamount to controls in the whole field of foreign payments and thus to all-embracing exchange controls.

Consideration of all the conceivable and probable difficulties points to the likelihood of a failure in the attempt to regulate the degree of expansion via the Concerted Action. That in turn would signify either continued disregard for the goal of price stability or else the apparent restoration of such stability at the expense of controls on trade and industry, i. e.

including measures for the direct regulation of the economy. In both eventualities, the Government would fail to achieve the objectives set out in the Law on the Formation of a Council of Experts with the approval of all political parties in the Bundestag: «the Council shall consider within the framework of the market economy how simultaneously to achieve price stability, a high level of employment and balance-of-payments equilibrium together with steady and appropriate economic growth.» If the Concerted Action does not succeed in attaining this goal, there is a second-best alternative. This flows from the elementary proposition that the economic policies pursued or tolerated by West Germany since the middle or end of the Fifties have not evinced by any means the simultaneous pursuit of these objectives. As the Government failed to strive for external equilibrium during the years marked by abundant accruals of monetary reserves with the exception of the modest revaluation of 1961, this country slipped from simple to more and more sophisticated full employment i. e. over-employment at the expense of price stability. Since the unemployment ratio has stayed well under 1% since 1960, the habituation to overfull employment has made people think that this must really be the goal of full employment. As a result, serious discussions are actually now in progress under the impression of a declining level of employment and sombre predictions on the anticipated volume of unemployment as to whether the dreaded relapse into a degree of under-employment such as we in fact deemed to constitute full employment only a decade ago is tolerable or not. In view of this pursuance of exaggerated goals, ought we not finally to realize that there can neither be an apt description nor a quantitative definition of full employment in terms of a certain ratio of jobless persons? On the contrary, both past experience and careful thought indicate in regard to developed economies such as that of West Germany that we can enjoy any desired degree of full employment if we are willing to pay the requisite price in the shape of open or accumulated inflation. As regards the direct attempts at a definition undertaken by those international experts who prepared a report on national and international measures to achieve full employment on behalf of the United Nations in 1949, allowance must be made in their undertaking for the limited amount of experience available at the time on the level of full employment attainable in a unilateral pursuit of this goal. Under fig 24 of their Report, the experts defined full employment as a situation in which its level cannot be raised by any increase in actual demand. The experts arrived at this clear-cut definition from their then held standpoint – and still widely accepted today – that there exists a hard indissoluble core of persons without work comprising the frictional and the seasonal unemployed. The outcome of this simple faith was, and remains the distinction drawn between genuine and spurious unemployment caused by a lack of demand and the determination of the unemployment ratio in any economy designed, as an estimate of the hard core, to present a statistical and objective picture of the aim of full employment. As we now know from experience, however, the ostensibly hard core of unemployment can dwindle to virtually non-existent proportions on a really overheated labour market due to the speed of switching from one job to another, the modest demands made of genuinely necessary professional qualifications, the hoarding of personnel and retention of workers during a seasonal lull, the decline in working morale and various other factors. By the same token, however, we know under a system of free price and wage formation that the «elimination of a lack of demand» as a prescription for obtaining full employment may produce the very same situation described in the fable of the hare and the hedgehog. The expansion of actual demand, corresponding to the role of the hare in the fable, will always prove inadequate and need to be continued at the expense of further inflation whenever an extravagant wage policy stimulated by blind confidence in the guarantee of full employment brings about an overcooled labour market by exaggerated increases in remuneration.

In view of the impossibility of defining the goal of full employment in direct terms or else doing so on a completely arbitrary basis, the only rational yardstick for assessing the pursuit of this goal by means of increased demand under a market economy remains that of the

impact on the value of money. An expansion of demand in the interest of full employment ought to be terminated as soon as its continuation would undermine price stability. The operation of this principle does not imply surrendering to fortuitous circumstances and irrevocably accepting the unemployment ratio or the level of utilization of the productive apparatus resulting from that magnitude of effective demand which does not affect the value of money. The generalization beloved of the orthodox adherents of the doctrine of full employment that a lack of demand is the only cause of under-employment stems in fact from the convenient and simple recipe of an «expansion in effective demand». A closer look at this issue reveals the many facets and deep-seated causes of underemployment, stemming above all from the Government's regulative policy. In summarized form, these may be described as distortions in the market economy's steering process caused by an inadequate indication of real shortages in the price system and by insufficient or faulty responses to these signals. A policy of full employment characterized by a wide-ranging use of regulative instruments designed to improve the functioning of the economic mechanism and the economic order – though admittedly more arduous and protracted than simply flooding the economy with demand – also serves to ensure appropriate and continuous growth, as an optimal use of productive resources is gradually accomplished. On the other hand, an inundation with demand promotes exactly the opposite situation. The belief that the scourge of inflation fosters growth by stimulating investment and occasioning enforced saving has become a form of self-deception since Keynes' «money illusion» is no longer accepted in a steadily growing number of cases and specifically in wage policy. Instead, appropriate account is now taken of creeping inflation. Moreover, the dimension of voluntary private saving – so important for economic growth – would no doubt be better served by price stability than by the crutches of expensive government schemes for promoting savings.

The most significant impact of a credible announcement that in future the goal of full employment will no longer be unreservedly pursued but only up to the point where the value of money could be jeopardised would be an annulment of the charter granted to the two sides of the industry and other interest groups in the economy in the form of a clear promise to ensure full employment. This privilege, conceded against the background of under-employment during the world economic crisis, granted them a far-reaching degree of control over the fate of the German Mark because it released them from responsibility for the consequences of their activities in fixing wages and prices under a market-economy system characterized by autonomy in negotiating collective wage agreements. A further consequence of a sharing of control over the currency between the State, the Central Bank, the two sides of industry and other private bodies was that nobody now felt really responsible for the objective of monetary stability. The hot potato of ultimate responsibility was tossed from one side to the other in this game, which has been played ad nauseam in recent years. The fact that neither the Government nor the Bundesbank enthused particularly about the need for an effective safeguarding of national monetary measures against external influences is much more understandable than the reasons cited in official announcements for the passive stance adopted on exchange-rate policy. In view of the shared responsibility for the currency, the Government and the Bundesbank should have reckoned with the fact that the opportunity for stabilizing the prices pursuant to the provisions on safeguarding the economy against external influences could not be grasped by them as the legal guardians of the German Mark if they could not rely completely on the loyalty of the privileged pressure groups pushing for full employment policy. The «Concerted Action» is intended to attain this goal by voluntary moderation. If the campaign is not at first successful and the Government does not wish to capitulate without accomplishing price stability, then there will only remain a tougher course of action consisting in a qualified degree of full employment as a means of winning prosperity without inflation. This might serve as a useful framework for a second attempt at a «Concerted Action» so as to dispel any misgivings on the part of those concerned that any breaking of ranks might conceivably prove to be advantageous. Both for

the Concerted Action and for a policy of qualified full employment, the protection of the economy against external influences by means of a firm policy on exchange rates forms an essential condition for success in the struggle to bring about price stability. An abandonment of this precondition would make it clear that such stability is still deemed to be only of secondary importance.

State Intervention in a Market Economy

The Advisory Council

to the Federal Ministry of Economics

1979

The Task of Designing a Market Economy System

A. The Greater Efficiency of the Market Economy

[. . .] 11. Market economy systems are characterized by great efficiency. However, the reasons why they are so much more efficient seem to be increasingly overlooked. It would seem appropriate to recall them here. The starting point is the need to coordinate economic activity in a society. In the small group (family, work team, etc) this can be done through direct agreement, but the coordination of the activity of millions of people always requires mechanisms of indirect coordination. By far the most important indirect coordination mechanisms are rulings within the framework of bureaucratic steering systems and the market mechanism, whose primary instruments of coordination are prices and contracts.

12. Certainly, the mechanisms of direct coordination in the small groups have an important function. But with the large degree of division of labour which is characteristic of a modern industrial society and necessary for a high standard of living, indirect coordination is essential and it is becoming more and more important as technological potential and the standard of living increase. Understandable as the desire for simple conditions is, in which the anonymous powers of bureaucracy or the market play no part, the price for their realization is very high. Only those who are willing to accept a considerable drop in their standard of living can afford to opt out of social interdependence. But those who wish to pay this price should be able to do so. It is easy to achieve this independence in a market economy, for one of the advantages of the system is to enable minorities to exercise their preferences, express their opinions and choose their own way of life. But bureaucratic coordination mechanisms enforce conformity and conformism.

13. An essential factor in the greater efficiency of the market economy as compared with

bureaucratic coordination is the better processing of information through the price system. Each economic subject receives the information which is relevant for his own decisions through price signals and is not affected by information which is not important for him. So the market economy system has a high capacity to process problems because it breaks down certain allocation tasks into partial tasks and sets about solving them de-centrally and step by step. Each act releases signals which serve as information for further decisions. The breakdown into partial tasks comes from the division into many specialised markets. Planning and action are constantly adjusted to changing market signals and hence gradually adjusted to each other. Furthermore, in a market economy individuals have so much less incentive to give wrong information the stronger competition is.

But with the centralised decision-making structure in a bureaucracy, those responsible for decisions receive a mixture of relevant and irrelevant information. They cannot be so well informed as they should be for their comprehensive powers of decision. Moreover, they are sometimes deliberately wrongly informed by individuals who can hope for advantages to themselves from the exercise of such strategies in a knowledge of the rules of the system.

All in all, therefore, non-market economy steering systems have higher information and regulation costs than market economy coordination. These higher costs will rise overproportionately if market economy organization forms are increasingly repressed and the information and coordination function of an increasing number of markets lost.

14. If the market economy system solves the problem of what, how and for whom production in the given state of social knowledge is better, it is also a better system for the acquisition of new knowledge. Competition as a process of discovery (cf. § 23) encourages the search for new and unconventional solutions which have to prove their worth in competition with traditional methods. The price system gives signals of shortages in resources and hence also for the direction of a promising search for technical and organizational progress. But bureaucratic procedures do not produce a comparable system of signals. So state research and technology policy, for example, cannot do without the shortage signals from the market. In bureaucratic economic systems, it may be possible to produce great achievements in certain areas but the efficiency of the system as a whole always suffers. The high rate of overall technical and organizational progress in market economy systems can only be achieved by bureaucratic systems if they imitate the market economy.

15. Coordination in a market economy is in principle open, bureaucratic subordination is a system which in principle is based on exclusivity. The market economy system of coordination is open in many respects. It is open to change; it lives on the pragmatic spirit of experiment, any person who has the necessary knowledge and the necessary means is in principle free and is offered incentives to act as innovative entrepreneur and enter the market with new technologies, products and forms of organisation. The result of these experiments, whether they are commercially successful or not, improves the general state of social knowledge. Entrepreneurs are usually quick to imitate new and successful methods so that the social benefit is generally greater than the gain to the initiator. The freedom of action and movement which the individual enjoys makes the market economy more open to changes in the behaviour and style of living of its individual members. It favours variety of production and patterns of living and variety in work organization. With a consistent use of its principles of order, it is also more open to the rest of the world: through free trade and free movement of people and material production factors, it permits participation in the social advantages of the international division of labour and of innovation abroad. International economic integration also improves the financing potential for innovations which require large resources by enlarging markets and through international movements of capital.

16. Bureaucratic regulation of economic activity, on the other hand, tends to isolate the system. To maintain control, prevent unexpected developments and minimize the repercussions of unforeseen events on the system as a whole, experiments and innovation are made subordinate to tradition and routine, and dogmatically defended ideologies prevent the

apparent superiority of these to anything new from being disproved by experiments or any other experience to the contrary. The variety and multiplicity of patterns of living and forms of work organization and production programmes are limited by a trend to uniformity and conformity. The freedom of action and movement of the individual are a potential source of disturbance in bureaucratic systems and attempts are made to limit them. Wherever bureaucrats come to dominate, therefore, there is a large degree of schematisation, uniformity and restrictions on individuality.

This tendency to screen the economy from outside influence may be seen in the forms of protectionism and state intervention not only in the state controlled economies but in the Western economies, too. Concrete «protection» of the domestic economy comes first and hinders perception of the more diffuse, but also more comprehensive advantages of world-wide economic integration.

B. A Market Economy System Needs the State

17. The organization of social economic activity as a market economy system can only be established and stabilized by acts of state. By creating the appropriate legal framework in the legislature, the administration and the judiciary and by providing public resources, the State directly and indirectly influences the allocation of resources. State activity of this kind is not a foreign element, it has its proper place in the market economy system as a whole.

18. The State must correct the results of market activity where the market is not functioning properly. The external effects of production and consumption are an important instance of this. If those who are negatively affected by private economic activity cannot make private agreements with those who are benefiting, it is the task of the State to ensure that these external effects enter into the cost and yield calculations of companies and the benefit calculations of private households by issuing positive and negative injunctions, imposing fees or special taxes and where necessary granting subsidies. That is particularly true of generally accessible resources such as water and air.

19. The openness of a market economy constantly exposes its subjects to economic risks. There are institutions of insurance and the diversification of production and sales markets are also inherent forms of insurance against risk, but they can never give complete protection. It is one of the major tasks of state policy in a social market economy to make the remaining risks bearable. State policy must take account of the fact that those whose efficiency is impaired cannot achieve the income they require to satisfy their most important needs: the income distribution resulting from the price mechanism therefore needs correction for considerations of fairness and justice. Similarly, it must be borne in mind that the equality of opportunity which is legally established is not matched by the very different degrees of ability in people to acquire the qualifications which are important for working life.

But in insuring against risk and effecting some redistribution, state policy should not go so far as to bureaucratize the system and cut it off from outside influence. It must not create more security and equality by curtailing individual freedom and the dynamic of the market through protectionism and regulation. Nor must it undermine the sanction mechanism which brings income disadvantages and material loss for individual inefficiency or disinterest in work. In Sub-section C, the positive aspects of the task of designing a market economy system are discussed.

20. An integral part of a market economy system is the stabilization of the level of the overall economic process through macroeconomic management, for the real markets and the institutions which surround them do not in themselves guarantee a steady development of the economy as a whole. But macroeconomic management will not be able to avoid or remove all the disturbances to general economic activity. So the aim should not be

perfectionist and detailed steering but only steadying of the cyclical process over the medium term by macroeconomic management.

The effectiveness of stabilization policy depends to a decisive degree on the flexibility of the price system. Where price formation according to the principles of competition is restricted, this not only delays the necessary structural change but also blocks the transmission mechanism which transforms the measures of money and fiscal policy into the desired stabilization on the goods and factor markets. Stabilization policy, however much it may be under short term pressure, must not become an obstacle to itself by making exaggerated promises to groups, especially the parties to collective bargaining, which free them from the risks arising from behaviour which is contrary to stability.

21. It is extremely difficult to decide where to draw the line between state activity and production on the market. In principle, goods and services which can be produced in a market mechanism should be produced in the private sector. Exceptions from this principle should only be permitted for compelling reasons. There may be compelling reasons for large parts of the education and training system, communal services and supraregional transport. But repeated checks should be made to see whether the arguments in favour of state provision are still valid in new situations. Certainly, there is no compulsion to ensure steady expansion of this type of state activity. The need for constant revision also applies to state activity for social security, when it entails state provision or leads to a re-distribution of incomes. With increasing prosperity, individual provision for the future should acquire growing importance. The will of the individual to make provision for his own future should be strengthened and efforts made to ensure that private measures to this end are not rendered valueless by inflation (cf. The Report by the Advisory Council of May 10, 1975 on «Indexierung wirtschaftlich relevanter Größen», Vol. 8, p. 701 ff.)

C. The Elements of Market Economy Organization Competition

22. The core of a market economy is freedom of economic activity, limited and steered through competition and the law.

Competition is an instrument for the realization of consumer wishes on the market and the use of production factors on as economically favourable a cost basis as possible. Entrepreneurs plan production on the basis of their estimate of demand which they can only influence to a limited extent, and the future development of the market. Accurate prognoses and the corresponding production are rewarded by profit but this is exposed to erosion by competition from the same or similar products. Profit-making over the longer term under competitive conditions therefore entails constant new achievement. Wrong estimates of the market will be revealed by the price mechanism; they will result in losses and in an extreme case may force a company off the market. A de-centralized structure, however, generally means that the effects on the economy as a whole of wrong decisions by entrepreneurs are limited.

23. Competition is also a means of discovering solutions to problems. These include innovations such as the introduction of new products and production methods and new forms of organization. New goods are not invented by consumers but by entrepreneurs, who develop them and offer them for sale; but the consumers decide on the commercial success of the innovation. The advertizing in connection with the introduction of new products is often criticized by the general public as manipulation of consumer requirements. But under competitive conditions these criticisms are largely unjustified. The main effects of advertizing can be seen apart from changes in market shares of individual firms in the activation of latent demand for new products.

24. The effectiveness and the function of competition are jeopardized if private economic

power – often with the use of legal instruments – prevents or hinders the emergence of new competitors or if there are agreements to limit competition. It is often said that the emergence of economic power is inherent in a market economy so that the existence of a market economy based on competition is impossible over the longer term. An analysis of the different causes of the emergence of economic power, however, will show that this can be very effectively countered. Competition policy up to now has by no means, as is often argued, been unsuccessful, but it is necessary to keep improving the range of legal instruments available in view of new developments and experience.

25. Of no less importance than competition policy in the narrower sense is an economic policy which is consistently geared to competition. For a country like the Federal Republic of Germany the maintenance of the freedom of foreign trade will play a particularly important part. In many cases, it is only through foreign trade that markets can be created of a size big enough to allow exploitation of economies of scale without at the same time weakening the intensity of competition.

26. Effective competition presupposes that consumers recognize and exploit fully the advantages which competition between suppliers opens up to them. These conditions may generally be regarded as given on the producer goods markets, but not on all the consumer goods markets. To enable consumers to make a proper comparison of alternative offers and so make better use of the advantages offered by competition, it is essential to provide them with information. But this should not degenerate into telling them what to do. Handled properly, information to consumers is the complement to state measures to ensure competition.

27. Maintaining the efficiency of competition and improving this as far as possible is a permanent task of economic policy in a market economy and it must on no account be sacrificed to apparently superior structural aims. It is necessary not only to expand the existing laws on competition and improve their application; the basic line of economic policy must in fact be directed to strengthening competition.

The Correspondence between Risk and Incentive as a Task for Economic Policy

28. Every system of allocation (and not only that in a market economy) must necessarily also be a system of incentives. To achieve socially acceptable results, the incentives must be all the stronger the greater the risk to those who have to take decisions. Economic policy must draw the appropriate strategic conclusion from this recognition and ensure that there is adequate correspondence between risks and incentives and maintain this over the longer term.

During recent years, this correspondence between risk and incentive has been increasingly disturbed. While on the one hand the risks of economic activity have risen for many – and, in comparative terms, least of all for big companies and employees – the incentives have clearly lessened. There are many reasons for this. The risks are greater i. a. because

- the danger of a growth in protectionism must be rated higher throughout the world than five years ago, and this particularly affects longer-term decisions by the export industry;
- the prognosis of the future relationship between goods and factor prices has become increasingly difficult for several reasons (world-wide inflation, the power position of foreign suppliers of energy and raw materials, the power of the social partners, etc.) and this makes many investment decisions more difficult;
- entrepreneurial decisions are being restricted in every field through an apparently inexorable growth in the number of laws and rulings, which not only makes planning more difficult but also often considerably hampers the implementation of decisions.

On the other hand, an increasingly critical attitude to the income distribution effects of economic incentives has led to a reduction in these incentives. As this continues, profits are

being increasingly seen and evaluated from the point of view of distribution rather than allocation. In this report, it is not possible to discuss in detail all the relevant viewpoints to this question, although they are important, and only some of the aspects which are of especial significance today will be taken as examples.

29. The disregard for the functional importance of profit discernible in recent political discussion is a cause for concern. Profit expectations are the prerequisite for investment and hence the creation of new and better jobs. Profits in good years help to stabilize production and employment in bad years. But in a market economy there can be no guarantee of profits. Only where the State permits competition to be eliminated or where it excludes competition itself is it possible for profits to be made over the longer term without a corresponding market performance.

A further cause for concern is the failure to recognize the incentives which come from windfall profits. Their particular function is to stimulate an extension of the range of goods on offer on the appropriate market and/or relax the situation on the markets for substitute products. Generally, the range on offer is extended pretty quickly so that windfall profits are only short-term.

30. The function of profit as a prerequisite for investment and as a stabilizing factor for enterprises must be recognised by all the participants in the market economy, especially those who have the economic or political power to influence profits. These include not only those responsible for state economic and finance policy but also the trade unions. A wage policy which leads to a constant reduction in the share of profits in the national income is bound to have a seriously detrimental effect on the function of the market economy over the longer term. A rigid wage policy, which is able to achieve its ends regardless of the cyclical situation, is bound to jeopardize companies and hence jobs. As far as possible, therefore, efforts to realise redistribution aims should not be through wage policy but finance and asset formation policy measures, although there are limits which should be observed. (cf. §§ 32 and 33).

31. The incentives which are essential if economic risks are to be taken and if there is to be a will to performance can be decisively weakened through misapplied or exaggerated personal re-distribution.

That applies to functional income distribution at present, insofar as wage and salary structures are increasingly being determined from the point of view of personal distribution. A characteristic feature of the growing importance of the re-distribution aspect is the growing disproportion between changes in wage structure and actual relative scarcities in the economy. This is increasing the danger of unemployment through rationalization. The Council has dwelt on this point with considerable emphasis elsewhere (cf. The Report by the Advisory Council of July 4, 1977 on «Rationalisierungsinvestitionen», Vol. 9, p. 843).

Moreover, the growing importance of certain aspects of personal distribution in functional income distribution is lessening incentives, both among those who are benefiting and indirectly among those who are relatively disadvantaged.

The opinion recently put forward that a wage negotiation policy aimed at levelling can ease the system of state re-distribution is illusory. On the contrary, the disturbance of the market mechanism on the labour market which this causes leads through the increase in unemployment to greater use of the state system of social insurance.

32. The essential economic incentives can also be weakened by excessive personal re-distribution with the help of income transfers. We will not discuss in how far this is already taking place. But it is clear that the share of transfer income in the disposable incomes of the households which benefit is in some cases fairly high. The cumulation and total of transfer income may weaken the desire for higher income from individual effort, particularly in important threshold zones. It is especially difficult to estimate the extent of such effects if there are different income thresholds for different social benefits, as is the case today. Moreover, the co-existence of several different kinds of social benefit not only means that

these accumulate to an inappropriate degree in some cases, but also that others who are in need are inadequately supplied. A simplified and uniform transfer system which makes the extent, direction and effects of the re-distribution processes more transparent, would be preferable to the existing system.

33. The question is repeatedly raised whether the existing burden of taxes and social security payments has not reached a level which is paralysing the will to perform and the readiness to take economic risks. The following may be said:

The ratio of taxes in the economy of the Federal Republic of Germany has only fluctuated by about one point – a maximum of 2 points – during the last two decades, and no trend to change is discernible. The ratio is between 24 and 25 percent of Gross National Product. But social security contributions have risen considerably. The total compulsory contribution ratio is now over 39% of GNP. Insofar as it is regarded as necessary to reduce this total ratio, the aim should be to do so through social insurance policy measures. (However the effect the public sector has on the allocation process in the market economy goes far beyond this. A considerable part of total public expenditure is not financed through these compulsory contributions but through borrowing, fees and other contributions together with income from public enterprise and public assets. Apart from the financing, we have not discussed the effects of the scope and nature of state expenditure as such on the economy as a whole. The ratio of total state expenditure has now risen very much more than the ratio of taxes and is about 48%. A further increase would jeopardize the maintenance of the market economy system.)

As far as taxes in the narrower sense are concerned, even if on average – and in comparison with other countries – they cannot be regarded as excessively high, the possibility may not be excluded that they should be regarded as too high for certain individuals and/or groups. Where that is the case, a negative effect on incentive can already be observed. That is so for many companies, especially medium-sized firms, but it is also affecting the inclination to do intensive and/or more extensive work among a growing number of skilled workers and many white collar workers. If other conditions remain the same, this will be all the more so the higher the inflation rate is and the more the interaction of inflation and tax progression subjects even nominal income growth to rising tax rates (cf. The Report by the Advisory Council of May 10, 1975 on «Indexierung wirtschaftlich relevanter Größen», Vol. 8, p. 713ff.). In addition, taxes independent of earnings, at least when they exceed a certain level, may have a negative effect on the readiness of companies to take risks.

34. Particularly small and medium-sized companies are negatively affected by an imbalance of rising risks and reduced incentives.

The readiness to take risks with certain economic incentives largely depends on the possibilities within the company of lessening the overall risk through a broader distribution or spreading individual risks. In this sense, the large company has the law of large numbers on its side. More sickness leave or maternity leave, for example, would probably affect it less than a small company. Moreover, the big company with its wider production range will be less affected by risks on individual markets than a more highly specialised smaller firm. In addition, a shortage of capital often makes it difficult, if not impossible, for a small company to make necessary changes in its production programme. Finally, the growing complexity of legislation gives rise to additional costs and the risk of being exposed to a continuously growing flood of regulations affects a small company much more than a large company, which can hand over the adjustment of its decisions to specialists whom it can appoint or consult for the purpose.

If big companies are subject to a crisis, it must be expected that the effect on the local or regional labour market will be relatively great. To prevent massive local unemployment, those responsible for economic policy have in the past repeatedly agreed to offer support. As smaller companies cannot count on state aid in a crisis, they are exposed to a comparatively greater risk in this regard as well. If the selection function of the market according to

competitive criteria is to be maintained, the market structures must not be distorted through one-sided intervention by the State in favour of large companies. «Immortality through size» must not become the rule for survival on the market.

35. These comparatively greater risks, which have increased further in recent years, for smaller and medium-sized companies, are not matched by a comparable growth in incentives. This in part explains the observable decline in the number of smaller and medium-sized companies and the decline in the readiness to found new enterprises. Especially in comparison with the USA, where the majority of new jobs in recent years has been in new companies, the Federal Republic of Germany is in an unfavourable position.

36. Economic policy should counteract the negative changes to market and competition structures resulting from the reduction in the number of companies in a number of ways. The regulations on starting new businesses, for example, which are based on formalized proof of qualification (within the framework of the craft regulations, for instance) should be re-examined. Measures should also be proposed which would reduce risks which are in principle avoidable. A main point of focus should be greater clarification of the existing legal and administrative regulations. Above all, however, economic policy should help to reduce the advantages which still accrue to large companies for example from orders, from state job insurance, government grants for research and other support measures, and, however great the political pressure may be, avoid such measures.

Choosing the Best Instrument for Each Function in the System

37. The efficiency of the market economy largely depends on the choice of the appropriate instruments for the various tasks. Appropriate in this context means that the institutionalized regulations and other instruments should be used for that task (allocation, distribution, stabilization) which they can best fulfil. As the Council recently pointed out in its Report on Problems of a New International Economic Order (cf. The Report by the Advisory Council of November 20, 1976 on Problems of a New International Economic Order Vol. 9, p. 789ff. (in English from Springer Books, Berlin-Heidelberg-New York 1977) and the report by the Advisory Council of November 15, 1975 on «Kosten u. Preise öffentlicher Unternehmen» Vol. 8, p. 760f.), measures and rules can only rarely be found which will at one and the same time prove optimal to realize allocation policy aims and distribution policy aims.

38. According to the «principle of the separation of the task areas» (loc. cit.), the price mechanism performs the task of allocation in a market economy. It has proved to be the best instrument for this. But where intervention in the price system has been used to pursue stability or distribution policy aims, the results have been generally disappointing for the direct aims. Above all it has become clear that the use of the price mechanism for other than allocation policy aims always entails a loss of overall economic efficiency.

39. Adherence to the principle not to use the price mechanism for distribution policy aims does not mean that these need be neglected. On the contrary, the broad range of measures of a re-distributive finance policy is available for this purpose; it can effect the re-distribution desired for general reasons through transfer payments graded according to income level, number of children or other socially relevant factors. A redistributive finance policy can also affect re-distribution through measures to encourage asset formation and a policy in education and training to encourage social mobility. All these measures are already being used intensively and comprehensively in the Federal Republic of Germany, but as already mentioned (§ 32) they are being used in such a way as to lead to undesirable cumulation and hence to a weakening of the necessary economic incentives, both among those who are benefiting and those who are disadvantaged.

40. Only in exceptional cases is it justifiable to use the price mechanism for socio-political

tasks. If «funds are to be used to give specific and limited relief to the low paid and those in special need» (cf. The Report by the Advisory Council of November 15, 1975, on «Kosten und Preise öffentlicher Unternehmen», Vol. 8, p. 759) and if supplements to incomes in the form of direct transfer payments cannot serve the purpose or would entail too high costs, preferential payments to these persons will be comparatively the best solution.

41. For a large number of the price interventions now in use to influence income distribution in favour of certain groups, conditions which would constitute a special case cannot be established. Insofar as they serve general distribution aims at all, these aims would be better served by state transfer payments. The political preference for the price instrument is due to the fact that it is easier to win public support for this than for a clear assignment of allocation functions to the price mechanism and distributive functions to measures and regulations in distribution policy.

But in many cases, price intervention cannot even be justified by general distribution policy. Often it serves particular interests of producers (enterprises and their staff in one particular industry) who have succeeded in winning political support to protect their earnings position through state price policy.

42. The worst offences against the principle of aiming to use specific state transfer payments to supplement and maintain earnings, and of refraining from using price intervention, which is not clearly distributive, are in European agricultural price policy. However, the Advisory Council did not consider the questions of the European agricultural market, which are very complex, in this context.

43. Another unjustifiable use of the price instrument to achieve distribution aims is the rent policy for subsidized housing. Public housing is provided at rents below market level for specific groups in the population. The supply is only made possible by the appropriate subsidies to the suppliers and the allocation is dependent on certain qualifications. But if only for practical reasons subsidized housing never only benefits the circle for which it is intended – many who deserve help do not get it and many who no longer really need it continue to live in «their» subsidized accommodation – this specific system of allocation and distribution was criticized as socially unjust by the Advisory Council in its Report of December 12, 1970 (cf. The Report by the Advisory Council of December 12, 1970 on «Entwicklung der Wohnungsmieten und geplante Maßnahmen zur Begrenzung des Mietanstiegs», Vol. 7, p. 583 ff.). It is also unjust both because the different nominal building costs of the various years on which the fixed rents are based and the historically different types of subsidy have brought about a wide range of subsidized rents. The distribution effects of such an uncontrolled differentiation of the market are largely arbitrary and the allocation effects must be judged as negative. The provision of housing to the population is not as good as it might be.

44. The use of the price mechanism for allocation tasks avoids these disadvantages and leaves the incentive effects of prices and profits intact. If undesirable distribution effects arise, they can be compensated as far as demand is concerned through personal subsidies. For housing, personal subsidies to low-paid groups can be tied to the use of income for this commodity, the purchase of which is in the best interests of the consumer himself (individual support). But this type of subsidy which is linked to a particular item must be limited to cases of social need and to a very small range of goods, for this type of transfer in natura will have serious disadvantages for other aims: it puts the recipients subjectively into a worse position than income subsidies which are freely utilizable; it narrows their freedom by dictating consumption and requires a considerable supervision of financial circumstances and consumer behaviour which is difficult to practice. If one category of persons is hit particularly hard through certain price developments, income subsidies which are freely utilizable are to be preferred as a general rule.

45. Individual subsidies through aid to certain consumers if supply is not fully elastic leads to rising prices, so that those consumers who are not receiving subsidies suffer real loss

of income. If at the same time a minimum standard of the supply of certain goods is to be achieved and the market price is not to be raised through these subsidization measures, a mixed system of subsidies to suppliers and consumers would be preferable to pure consumer subsidies. With such a mixed strategy, price restrictions would not be necessary at all.

D. Experiments in the Market Economy

46. This discussion of the elements of a market economy system must necessarily remain general and incomplete. The basic principle of de-central organization through markets and the corresponding principles of the organization of the market economy system do not, for example, determine what the patterns of competition are to be, what the constitution of the labour market should be or what company constitution should be. The market economy is therefore open to experiment not only in the workings of its markets but also in its various forms of organization. It offers a chance to try out alternative forms of organization for its decision-making bodies, or of the constitution and framework of the markets, and enables progress on the basis of a comparison of alternatives.

However, there is an essential restriction on organizational experiments which must be observed: the decentral decision structure must be maintained and it must remain efficient. This must be ensured by maintaining competition, a balanced relation between incentive and risks and an efficient division of tasks.

47. An important example of the possible further development of the concrete organization of a market economy may be seen in possibilities for co-determination by workers and employees in company decisions.

Proper co-determination naturally requires preparation and the appropriate training measures. If there is a feeling of involvement and at the same time proper understanding, it may be expected that this will have a beneficial effect on the efficiency of the company. In the same way, understanding for the risks of company decisions and for the necessary compensation in the form of profit chances should be strengthened.

On the other hand, it should not be overlooked that codetermination in the company will probably change the relative weight attached to risks and opportunities. The shift of decisions to bodies on which workers are represented will probably mean that risks and chances are seen more from the point of view of their immediate effect on employment and less from that of the survival of the company. This may lead to a neglect of the longer-term perspectives in company development, which again may lessen the attractiveness of the enterprise as borrower and as employer.

There is much to suggest that participation by workers and employees in company decisions will also put more weight on questions of levelling wage grades. Insofar as the effects on employment and increases in cost indicated in § 31 occur, the benefit to those involved would only be apparent.

48. Many of the effects of the participation of workers and employees in company decisions are at present still difficult to predict and assess. In the interests of a further development of the market economy, it would therefore be desirable to try out various forms of codetermination; this would enable a judgement that had been empirically tested in fundamental experiments to be given.

The negative effects outlined above would certainly diminish if a growing number of workers were co-owners of their firms. On the one hand, this strengthens the staff's interest in the long-term development of the company so that they pay more attention to its competitive position and hence its long term stability than if they were only employees. On the other hand, a new approach would be needed to the problems of negotiating wage contracts.

49. To cope with economic difficulties which have risen in recent years, a large number of proposals have been made to introduce economic policy instruments which have not been used before at national or international level in a market economy system, or used only in exceptional cases. These include the «new» forms of protectionism in foreign trade and industry protection, direction of investment and the rather weaker measures of an active direction of structural change.

A. The Spread of a «New» Protectionism

50. For some years, a «new» wave of protectionism has been spreading in the western world; existing tendencies to differentiate in the treatment of trading partners are being increasingly strengthened. This is being done not only with the use of traditional trade restrictions (i. e. quantity and value import restrictions, administrative trade restrictions, special levies on imports, stricter rules on technical norms and certificates of origin, discriminatory practices in giving public orders and so on) but also with new measures such as bilateral voluntary restriction agreements and international agreements on «orderly marketing». Protectionism is also often concealed behind anti-dumping levies and counter-vailing duties. The discussions on a «new international economic order» have also included the possibility of international agreements to regulate raw materials markets through prices and import obligations.

A characteristic of this «new» protectionism is that it largely consists of direct intervention in markets through quantity restrictions on imports, the fixing of minimum prices, regulations on market shares, etc. A steady increase in the cost of imports through duties is not so discernible.

Protectionist measures are affecting both the trade between the industrialized countries and the developing countries and trade between the industrialized countries themselves. Even trade between the member countries of the European Community has been increasingly affected by trade restrictions in recent years; clearly, the individual countries are interpreting the joint liberalization agreements differently.

51. In the European Community, apart from agricultural products which are almost completely shielded from international competition by the EEC agricultural market regulations, protectionist measures are being increasingly applied to steel, textiles, clothing, shoes, leather goods, electrical and electronic appliances, bearings, chemical products and ship-building. In steel, a minimum price system is at present being applied analogous to the agricultural price system designed to protect the supplier countries through voluntary agreements to restrict exports. Until the necessary agreements are concluded, anti-dumping duties are being levied. In textiles and clothing, voluntary restriction agreements form the core of «orderly marketing». Admittedly, annual growth rates are envisaged for imports of the various products but that does not prevent individual export countries from having to take a considerable drop in their exports. It also makes it very much more difficult for new and efficient suppliers of textiles and clothing to enter world markets. Import quotas are imposed on trade with the state-trading countries who have not yet concluded voluntary restriction agreements with the EEC. In shipping, efforts are being made to «share out» markets; at the same time, international agreements are to be concluded to reduce the present capacity and prevent aid to the Third World to expand its capacity.

52. The arguments in favour of obstacles and restrictions on trade are that

- as foreign competition increases, labour is made redundant on the domestic market and this intensifies the present unemployment problems in the industrialized countries;

- cheap imports, especially from the Asian countries, are increasing the over-capacity which already exists in the «sensitive» industries such as steel, shipbuilding and textiles;
- distortion to competition has arisen as a result of different national industry and structural policies, especially competitive subsidizing;
- the Eastern bloc countries have entered the markets of the industrialized countries with relatively cheap goods, although it is not clear whether the lower prices are the expression of comparable cost advantages;
- reduction in demand on certain markets is of a temporary nature, but could jeopardize the existence of many enterprises over the longer term;
- in view of the world political situation, certain lines of production cannot be handed over fully or largely to other countries for security policy reasons;
- protectionist measures reduce the risk to domestic industries and thus make long-term economic calculations easier or indeed possible;
- the increasing integration of the domestic economy with the economies of other countries is narrowing the room for an independent economic and social policy geared to specific national aims.

53. Special attention should be drawn to the restrictions on exports, which are increasingly being imposed. They are justified with the argument that

- newly acquired technical knowledge cannot simply be «exported» because this jeopardizes the competitive position of the domestic industry on the world market;
- a re-orientation of domestic producers from the world market to the domestic market could reduce inflation;
- it is desirable to improve the terms of trade by limiting supply and so improve national prosperity;
- the processing industry should be supported, as a restriction on the export of raw materials will lead to lower prices for raw materials to domestic producers.

54. Almost all the tendencies described here are symptoms of deep-rooted structural changes which have been going on in recent years. The battle against world inflation through monetary restrictions, the introduction of flexible exchange rates, the emergence of new technologies and the accelerating progress of the developing countries on world markets have inevitably caused considerable national and international adjustment pressure. These measures are an attempt to avoid this and the «new» protectionism could be described as «refusal to adjust».

B. Criticism of the «New» Protectionism

55. The refusal to adjust and the adoption of corresponding protectionist measures generally leads to a great loss of efficiency and particularly growth. There are several reasons for this:

- Import restrictions burden consumers with higher prices. At the same time they cause a drop in production for the export industry, or a slower growth in foreign sales. For trading partners whose sales on the domestic market are restricted have to cut back their purchases from domestic producers if only for financial reasons. The domestic economy is then no longer in a position fully to utilize the comparative advantages the country has on the world market. Where there are restrictions on imports of raw materials and semi-manufactures, the inputs to downstream industries also become more expensive. Insofar as the export industry belongs to these sectors, this again lessens its sales chances on the world market and the opportunity for making use of vertical division of labour.
- Import restrictions in one country generally lead to greater use of protectionist measures by other countries. This will certainly be the case if the Federal Republic of Germany, which

has a world-wide reputation as a great exponent of the concept of free trade, adopts protectionist measures or – as a member of the European Community – approves these. This would probably encourage many other countries to move further than they have done so far away from the spirit and the letter of the GATT treaty.

- Increasing protectionism abroad is bound to cause considerable loss of income to the Federal Republic of Germany in view of its high dependence on exports. This will already be the case if approval of protectionism at home makes the German export industry uncertain, so that there are fears that access to the world market will become increasingly difficult and there is a corresponding cut back in investment. For this reason, the Federal Republic of Germany – and every other industrial country – should unilaterally be prepared not to introduce trade restrictions even if plausible reasons could be given to other countries for doing so.

- Protectionism reduces the participation of the domestic economy in technical progress abroad and leads to a reduction of dynamic competition.

- State attempts to protect national markets and to achieve an international share-out of markets subject economic decisions to an increasing degree of political decision-making. They cause considerable organizational and practical difficulties, as inter alia bilateral or multilateral negotiations are necessary with the governments of several countries in order to achieve the required division of markets, while it is at the same time necessary to ensure that the industries concerned keep to the agreements.

- The argument that protectionist measures facilitate long-term economic calculations and favour economic growth can be empirically disproved. Especially experience with the European agricultural market (but not only this) has shown that uncertainty among producers tends to increase. The decisions that may be taken on import protection, minimum prices, etc., are generally less easy to predict than market developments in free trade.

- The will to adjust to changing market conditions is weakened when companies are protected. Their efforts are directed to acquiring more state aid and further protectionist measures rather than re-gaining profitability.

56. Protectionist measures only ease a country's unemployment problems – if at all – for a very short time. The loss of jobs which is inevitable in some sectors of industry if there is no protection against imports is generally compensated by a growth in the number of jobs in the export industry and its related areas and a general rise in the number of jobs due to accelerated growth.

57. Existing capacity, which cannot be fully utilized owing to the emergence of new and more efficient suppliers, belated adjustment on the part of investors to a drop in demand or too optimistic an estimate of the development of demand, has no or only a reduced economic value. Protectionist measures to re-orient domestic demand from the world market to domestic enterprises may – although it does not always – lead to a re-utilization of this capacity; but this will not eliminate the economic loss in value. It simply transfers the loss from the investor to the general public who have to pay higher prices for the products, while at the same time productive jobs in the export industry are lost and often subsidies have to be provided to finance state aid. Generally, the re-distribution is not even registered by those who are negatively affected.

58. For some goods, over-capacity often develops in several countries at the same time. It has been suggested that in such cases the reduction in capacity should be regulated by international agreements so that the losses can be equally distributed. Quite apart from the danger that any regulation may cause reactions among those affected which make the desired aim unattainable, it should be remembered how difficult it is to develop economically satisfying criteria for such arrangements on an international level. Both nationally and internationally, the cost situation of companies in any one industry are generally very different. If under such conditions percentage cuts in national production capacities are

agreed, the efficient and the inefficient firms are equally affected. Production does not move to the sites that are most favourable on an international comparison.

59. The security policy argument in favour of protectionism is not convincing, except for very few products, because greater competition from imports does not jeopardize the existence of whole industries. Generally, enterprises which are affected can, by specializing in certain types or varieties of products, make use of the possibilities for a division of labour within the industry and profit from economies of scale.

60. The realization of the desire for a «national way of life» is not jeopardized by free trade. No-one is forced to buy the products of foreign suppliers. Nor is there any reason why national qualities should only lead to the appropriate range of goods if the domestic industry is protected.

61. The arguments in §§ 55 to 60 show that it is not advisable in economic policy to use protectionist measures to make structural change more difficult and prevent adjustment processes. That does not mean that there may not be exceptional cases where economic policy should influence the adjustment process. But this should not be done with protectionist measures but through a structural policy oriented to a market economy as outlined in Section «Intervention in the Economic Structure which is Compatible with the Market Economy System» of the Report.

C. Proposals for Directing Investment and Structural Change, and Arguments Used

62. Recent proposals on direction of investment and active structural policy, in contrast to a sectoral or regional structural policy in conformity with the market system (cf. §§ 89 ff.), are primarily aimed at extending the possibilities for general influence on investment activity and the structure of production. It is suggested that the direction of investment and structural change would be carried out by either state institutions and/or institutions established by industrial bodies at sectoral or national level, such as industry committees or «round tables», economic and social councils.

63. Neither direction of investment nor active structural policy are fully articulated economic policy concepts. Direction of investment is based on the idea that lists of social priorities should replace private choice in the investment field. This would enable the economic process to be «consciously structured by society». «Society's needs» would be defined by democratic parliamentary organs or by paritative economic councils or industry committees, and existing production structures adjusted to these requirements over the medium term.

It is argued that this procedure would prevent both bottlenecks and over-capacities on existing markets, lead to a better orientation of investment behaviour to long-term trends than would the market mechanism, reduce fluctuations in investment and hence have a steadying effect on the economic process as a whole as well as meeting «genuine» consumer needs. Some of the advocates of directing investment are prepared to accept that such a policy would not be feasible within the framework of a market economy, while for others supplanting the present system is actually the declared political aim.

64. The demand for direction of investment is sometimes toned down by the proposal to establish investment registration offices. Obligatory registration of investment plans would, it is argued, serve to prevent unfavourable structural developments. The question whether, if this aim is to be achieved, the registration offices are to be given powers to influence investment decisions, is left open.

65. Recent proposals on active structural policy, or direction of structural change, have been made less with comprehensive direction of investment in mind; they are presented instead as a way of improving the efficiency of the market mechanism. The structural change which is the necessary accompaniment of competition in a market economy would be

facilitated and the resultant employment problems avoided or lessened. An anticipatory structural policy would function as a «third pillar» of economic policy, supplementing macroeconomic management of the economy and «Ordnungspolitik» (regulatory policies, i. e. the systematic framework which orders the relations between individuals and groups in their economic activity). Its advocates recommend that a council of experts for structural questions be appointed, analogous to the council of experts for assessing macroeconomic trends. The new council would give estimates of expected structural change on the basis of structural reports and if necessary make recommendations to enable unfavourable economic developments to be recognised at an early stage. The council, which should be composed either of academic economists or of representatives of social groupings supported by economists, would not be given direct influence over government policy for encouraging investment or awarding subsidies.

D. Criticism of Direction of Investment and Structural Change **Direction of Investment and the Freedom to Invest**

66. A comprehensive direction of investment covering the economy as a whole, by an «investment control office» which had powers to command and forbid investment, thus steering it in various directions and determining the structure of production over the medium term, would mean the end of the market economy system in the Federal Republic of Germany.

A characteristic of the market economy system is the right to freedom of the individual, which, within the framework of the existing laws, gives the economic subjects autonomous powers of decision and enables them to act according to their own estimate of the market situation, the chances of competition and the prospect of profits. But an essential element in entrepreneurial freedom of decision is the right to determine the nature and extent of investment. If the freedom to invest of private individuals is curtailed, it must be replaced by other decision-making organs; but these can never be made responsible for wrong economic decisions in a way that is possible under the rules of an efficient market economy if the rules of liability are properly framed. If the power of investment decision is transferred to state or parastatal organs, only society as a whole can be made liable, i. e. in practice the taxpayer. But it is difficult for such decision-making organs to identify these interests adequately and they are often neglected altogether. There is the further uncertainty of the criteria in a system which is not based on private disposition and the resultant price mechanism.

67. While binding prescription of investment is irreconcilable with a market economy system, non-discriminatory prohibitions on investment, as far as these are admissible within the framework of constitutional freedom to ensure the general interest, may be in conformity with the system, although this says nothing about their substantive allocative function.

Direction of Investment and the Allocational Efficiency of the Market Economy

68. A direction of investment which is limited to central framework planning and leaves the ultimate decisions on investment to entrepreneurs (indicative planning) cannot immediately be said to destroy the market economy system. But if the aim is for more than global influence on the investment ratio through measures of growth and cyclical policy, at least a proper concept of the «appropriate industry structure» for the economy would have to be developed and attempts made to induce the autonomous citizens to behave in the «proper» economic way. In all probability, however, a politically neutral and purely indicative

planning would not prove possible in practice. The effectiveness of indicative planning requires that a joint prognosis of future developments be made to which all are oriented. But under competitive conditions, that is an inherent contradiction. In a competitive situation, each entrepreneur and owner of factors tries to estimate the future development for himself, for his products and services or for the goods he wants to develop, and this future development is also determined by his actions. The greatest market success and hence the greatest deviation from the sectoral average will be obtained by that entrepreneur who has made the best estimate of demand and been most successful in innovation. Indicative planning is therefore either useless or else it destroys competition.

69. However, in practice it may be expected that less ambitious programmes will be evolved and only some areas of production oriented to the aims of the planners. It is then likely that measures which will have a selective effect will be used to induce investment according to the political concepts of the decision-makers. But these concepts will probably differ from those of consumers. If demand does not then develop as the planners expected, subsidies from public funds or tax concessions are inevitable and the allocation efficiency of the markets suffers lasting damage.

It may therefore be assumed that the chosen investment structure will not be the one which would have emerged in the market process. If the investment is for goods which are being produced for the market, it must be expected that the production pattern resulting from the decisions of the investment direction organs will not correspond to the preferences of consumers either in composition or quantity, so that bottlenecks and overcapacities will develop on the markets concerned. In such situations, there will presumably be increased political pressure on the bodies responsible for economic policy and/or directing investment to adopt measures to limit competition. In a country which is strongly dependent on foreign trade, this pressure will largely find expression in various forms of protectionism.

On the Practical Aspects of Directing Investment

Both direct and indicative-selective direction of investment create practical problems, although to varying degrees, to which to satisfactory solutions have so far been found.

70. The bodies which take the decisions or make the recommendations are to be either parliaments, economic or social councils or paritative industry committees («round tables») which would be bodies through which industry would regulate itself. The position of the last two named institutions within the parliamentary democratic system as a whole has not yet been settled (cf. Sub-section D, § 82 ff.). In both cases but particularly that of industry committees, it must be feared that largely producer interests will be represented, i. e. the interests of the entrepreneurs and employees directly concerned in production, and that the interests of both indirect producers upstream and downstream of the industry in question and of consumers would be impaired. A council («soviet») system would also jeopardize the general interest as the problem of serving the public interest could not be solved through general rules and a balanced constitutional order, but only through representation on the decision-making organ. There should then really be paritative bodies with representatives of consumers, workers and employees, shareholders, entrepreneurs, suppliers, pensioners, those receiving social security etc., but the democratic legitimation would still not be given (cf. Sub-section D, § 82 ff.).

71. In all forms of directed investment with fixed aims, the directing organs would have to establish more or less explicit «lists of social priorities». But there is no practicable procedure for the establishment of sufficiently differentiated and consistent economic scales of priority on the basis of majority votes and of adjusting these at the same time to the changing plans of consumers. Moreover, a scale of collective needs established by majority vote would not reflect the needs of the minority voters, so that special measures would be needed to protect

minorities, which in turn might conflict with the result of the voting. Furthermore, a scale of economic priorities established on the basis of majority votes would compete with the political decision-making process in which collective decisions regarding the community are supposed to be taken on the basis of identifying the over-riding social good in each case.

72. As a sufficiently clear-cut collective scale of priorities cannot be established by consulting citizens individually, in practice the political elite would have to take the necessary decisions. Then consumers would no longer have the means, as they have in a market economy based on competition for goods and incomes, to influence investment structure and the allocation of production factors through their income dispositions.

73. In public investment, there are many but not convincing attempts to imitate the function of the market and especially to clarify the estimates of consumers in order to ensure an optimal allocation of public funds to the individual areas. The problem which becomes apparent here would acquire very much greater weight if direction of investment were applied throughout the economy.

74. Experience with central directive mechanisms has repeatedly shown that there are very narrow limits to the capacity of the decision-making bodies to process problems and that these bodies are not in a position to grasp the real possibilities available and exploit them. Especially the democratically constituted public system would therefore be overstrained, both in regard to what can be planned and what can be realised, if it had to take on the highly complex tasks of directing investment.

75. Experience with analogous systems for directing investment and structural change has shown that the steering bodies tend to concentrate on large companies and give them better access to public funds. This puts smaller and medium-sized enterprises at a disadvantage and favours concentration tendencies.

76. It is unlikely that the steering bodies would avoid wrong investment decisions. The behaviour of those engaged in the economic process is oriented to expectations based on information from the present and the past. In a market economy, these expectations are revised in line with actual market situations and given data in the economic environment through the price signals and sanction mechanisms of the market. A body which is not directly linked to economic reality can therefore at best react only with a considerable time-lag to market changes and this in turn makes a considerable contribution to the emergence of bottlenecks and excess capacity on markets.

The Drawbacks of Investment Registration

77. In considering the demand for investment registration centres, it must be observed that gathering data on investment plans will not be neutral in its effects on behaviour and that it can have a negative effect on competition, especially innovation competition. If investment plans are made public, the possibilities for enterprises to gain competitive advantages from innovation in products and processes will be limited; the registration centres would hardly be able to withhold their knowledge of a company's investment plans from a competitor, especially on oligopolistic markets, nor would they want to do so, as this would be contrary to their purpose. There would then either be agreements to restrict competition or attempts to exercise an administrative influence on investment decisions by competitors and give the impression at the registration centre that the planned investment would not be opportune for general economic or other considerations.

78. Moreover, the gathering of data on investment plans would create considerable administrative problems, both with regard to the point in time at which the registration should take place (in the preliminary planning stages, when the formal decision process begins or not until the commencement of the implementation phase), statements on investment expenditure and expected future sales. The question would arise of how to

proceed over decisions which influence the utilization of invested production means of competitors. Rules would be needed for the handling of wrong registrations and the revision of investment plans or strategic measures to influence the market behaviour of competitors. The decision would have to be taken whether investment plans which had not been registered at the proper time would be allowed to proceed and whether the basis for the calculations should be revealed. Finally, it would have to be decided whether the registration centre should give a formal or informal agreement to an investment project and whether and in how far such an agreement would constitute a real financial asset to the beneficiary. If so, a decision would have to be taken on how the ensuing profits should be handled.

79. The experience which has been gained with the obligation to register investment for companies under the European Coal and Steel Community Treaty confirms that this is a questionable instrument. It has not been possible to prevent considerable excess capacity from developing in the steel industry and the European Commission and the Council of Ministers have used protectionist measures and dirigistic intervention in the price mechanism as a result. This must be judged all the more critically as a considerable part of the borrowed funds were provided by the Commission from European Coal and Steel Community loan issues.

The Practicability of Directing Structural Change

80. It would be conceivable to establish, instead of the types of investment and structural direction discussed above, a purely indicative direction of structural change. This would differ from the variants considered so far in that it refrained from active direction and restricted itself to a system of recommendations (positive and negative lists) with reference to apparently recognizable economic developments. The recommendations would facilitate the process of structural change in the market economy and improve the allocation process. The recommendations would come from a council of experts appointed for the purpose.

81. In criticism of this concept, one can say:

- It may be supposed that the allocation function of the market place would only be improved if it were possible to give prognoses of expected structural change that were reliable enough for entrepreneurial planning. If the structural prognoses came from the State or from an organ within the state sector, it would be difficult, within the political process, to make sufficiently clear that these were not state aims. Otherwise, the state bodies could be forced into a position of adopting economic policy measures to ensure sufficient demand for the goods and services which were the result of production decisions on the basis of the structural prognoses. Unlike the council of experts which now gives global analyses of general economic trends, the new council would give concrete recommendations for particular industries and enterprises and these could easily become the basis for demands for state aid. These doubts would cease to apply if private institutions gave independent prognoses in competition with each other.
- A system of public recommendations of which industries should expand in future (positive list) and which should shrink (negative list) is not compatible with a market economy. There is the further difficulty that central storing and evaluation of the knowledge now available among economic subjects for the purpose of indicative direction of structural change would entail great expenditure of time and work for processing the data. Before the data could be fully processed, it would be rendered obsolete through economic events.
- State bodies are continuously exercising an influence on the profit expectations of companies and hence the structure of the economy through numerous types of intervention (changes in exchange, rates, price levies, guarantees of sales, tax concessions, foreign trade measures). Public structural prognoses would therefore have to take state activity into account and include it in its recommendations. But precisely this would encounter the

difficulty (inherent in the system) that state activity is constantly being confronted with new political situations at home and abroad, and has to react accordingly. State policy therefore cannot be planned and forecast over the longer term in the way that would be necessary for structural policy.

E. On the Constitutional Aspects of Directing Investment and Structural Change

82. In contrast to the view that is frequently heard, the legislature is not completely free with regard to the framing of measures to direct investment and structural change. There are limits set by the constitution. A clear assignment of responsibility and accountability for the consequences of decisions are an essential prerequisite for the functioning of a democracy under the rule of law. A clear assignment of responsibility for investment decisions as well is also an essential requirement resulting from the constitution of a legal democracy (Art. 20, Art. 28, Para. 1, Sentence 1, Basic Law).

83. Under our constitutional system, there are basically two types of legitimation of economic decisions, including investment decisions. In the first case, persons and institutions may refer to the basic rights of property, of occupational freedom and of general freedom, which includes freedom of economic activity. In the second case, decisions are taken by political bodies which need democratic legitimation. This is generally given when parliaments take the decisions or if the governments which take the decisions are accountable to parliaments and for the rest are bound by the constitution.

The directing or monitoring of investment can mix the two kinds of legitimation in such a way that ultimately it is no longer clear who is responsible for which decision. That the State has already imposed a large number of restrictions on entrepreneurial freedom to invest is not an argument against the constitutional doubts outlined above. The traditional restrictions contained in planning permission orders, land-use zoning, environmental protection, factory safety regulations and so on always make it clear what the purposes, norms and corresponding procedures are and so show that the State is responsible. This type of control is quite separate from the entrepreneurial activity for which it is setting the framework. But the direction of investment and structural change now under discussion is not concerned with setting general framework conditions for entrepreneurial activity but with the apparent correction of «wrong» entrepreneurial decisions in individual cases and replacing them with «decisions that are right for society», whereby the purposes, norms and procedures are not clearly assigned to one particular policy body or organ. Intervention by the State and the decisions of companies would perforce be closely, indeed indistinguishably intermingled.

84. Such procedure would have far-reaching consequences. It would be impossible to limit democratic control of state activity to the State's share of the decision process and at the same time to cover this completely. But if it is no longer possible to separate the influence of political decisions from entrepreneurial decisions so that state measures as such can be subjected to actual control by parliament; the demand which is frequently raised for more democracy in the field of investment decisions cannot be fulfilled in the spirit of the constitution.

85. In any case, it is questionable whether investment direction or monitoring can be subjected to democratic control at all to the envisaged extent. The closer economic decisions are brought to the responsibility of government and parliamentary control by investment direction or monitoring, the greater is the likelihood that the parliamentary bodies will not measure up to what is required of them or that the efforts to meet these requirements will overstrain the democratic process.

This is now often admitted but it is argued that the task of investment direction should be transferred away from government and parliament to institutions of society, e. g. organs of self-regulation or mixed committees. But there are constitutional objections to this.

In a democratic society, the general public cannot simply be represented by groups or representatives of industries who are not accountable to it. In constitutional practice, there are many possibilities of transferring decision rights to special institutions, the courts, for example, legal entities or public corporations. But this needs careful and differentiated justification towards both the general public and those affected in each case.

Analogous to the rules which ensure the independence of judges, the autonomy of self-administration bodies or the autonomy of the central bank, it must be asked whether the departure from general democratic legitimation for the organs of investment control can be justified and compensated by appropriate structures. This depends on

- whether and in how far it is seriously desired and effectively possible to impose binding norms on the work and powers of such organs;
- whether and how far it is possible to guarantee the experts full discretion in applying their specialist knowledge and hence appoint the best people to such organs;
- whether and how far the choice of appointing authority and appointment procedure can be used to commit members to act in the public interest and thus bind them into the general political process.

86. Trying to legitimize direction of investment by putting it in the hands of those affected seems to be a non-starter. Allowing those immediately affected – i. e. investing companies classified by investment activity – to regulate themselves through bodies responsible only to them is surely not the intention and would not be consonant with the idea behind investment direction or monitoring. This approach would in any case distort or even suspend competition. Yet the other affected groups are so disparate, so widely distributed and inter-related in such a complex manner that in the final analysis they are equivalent to the electorate itself. Direction or monitoring of investment affects not only enterprises and their employees but consumers, recipients of social security benefits, public employees and so on as well. Nor does it affect companies or workers in a uniform way; beyond the immediately concerned enterprises and their employees, it has a varying impact on different companies or classes of company just as it does on different groups of workers (at plant level, locally, regionally or sectorally).

The dividing lines between different degrees and kinds of «being affected» are so tangled and imprecise that they cannot be used as the basis for a para-democratic legitimation of groupings in society as «estates» or similar pattern. Any attempt to do so would come to grief over the fact, evident whenever some other method than general and equal elections is tried as a legitimization of democratic organs, that a convincing formula has yet to be found which would be an alternative to the egalitarian system of democratic decision making supported by a compatible system of democratic bodies.

87. Quite apart from the high impossibility of organising the direction or monitoring of investment in such a way that it fulfils its purpose while fitting into the model of a democracy based on the rule of law, the constitution itself and the basic rights it guarantees would set immediate limits on any system to direct investment.

It is the task of the law to determine the content and limits of entrepreneurial freedom (Basic Law, Art. 14, para. 1, sentence 2; cf. also Art. 2, para. 1, Art. 12, para. 1, Art. 19 paras. 1 and 2). If concrete restrictions are imposed, they must be regulated by statute (Basic Law, Art. 20 para. 3, Art. 80 para. 1, sentence 2). They must not infringe the essence of the basic rights involved (Basic Law, Art. 19, para. 2). If the State cannot achieve its aim through prescription of prohibition while at the same time observing these basic rights, it must either give up its objectives or attempt to achieve them by its own means (administration by government, setting up public institutions or enterprises etc.) instead of relying on its citizens.

88. The constitution offers one more possibility in its economic provisions, namely nationalization through transfer to public ownership or other form of socialization (Basic Law, Art. 15, para. 2). But this is only permissible «through a law which shall provide for

the nature and extent of compensation» (loc. cit., sentence 1). However, direction of investment cannot and should not be a «fourth channel» bypassing private enterprise, nationalization and direct state responsibility and undermining basic rights.

Intervention in the Economic Structure which is Compatible with the Market Economy System

A. The Subject, Aims and Role of Structural Policy in a Market Economy

89. Structural policy, as will be shown in more detail later, has important functions to perform in maintaining, supplementing and correcting the way production takes place in a market economy. However, its role is more properly subsidiary to stability and «regulatory» (see § 65) policy than as a «third pillar» of economic policy. It must not – as has recently been demanded – come to predominate over competition policy, nor must it become a substitute for macroeconomic management.

90. The main concern of structural policy is the relationship of particular areas of the economy or elements of the national product to each other or their relationship to the whole. It therefore covers very heterogeneous phenomena, e. g. the means of production, which are particularly influenced by policies on education and training, land use, exploitation of mineral resources and on the environment. Of special importance in structural policy are measures affecting the sectoral composition of material production and factor inputs, the regional distribution of production and income and the size and number of enterprises (structural policy related to enterprises classified in accordance with their size).

In all the areas of structural policy, it must be remembered that structural change is rather slow and takes time. In special carefully defined cases, an active structural policy may be used to speed up the adjustment processes or, conversely, to slow them down.

As the criticism in §§ 49 ff. indicated, structural policy in a market economy cannot pursue independent «structural aims». It is the overall economic aims which are decisive. If an assessment of structural developments leads to the conclusion that these are running counter to the overall economic aims, intervention may be advisable.

91. The real task both of structural policy in general and of sectoral and regional policies in particular is allocative. The criteria for the assessment of the suitability of structural policy measures are those of static and dynamic efficiency. This assignment to an allocation policy role by no means excludes other general economic aims from the field of application of sectoral and regional structural policy, but these should be pursued with structural policy instruments on the basis of allocation policy criteria. A few examples will make this clear:

Basically the increased emphasis on environment protection amounts to extending overall economic efficiency goals to include external effects (cf. §§ 18). The environment policy aim that certain immission standards must not be exceeded in certain areas can as a rule be achieved by various measures. The choice of measures – apart from the question of system conformity (cf. § 97) – is an allocation policy task.

Where sectoral structural policies are used, the aim of securing supplies of essential raw materials, or, where this is not possible, reducing the risk of disruption to supplies, has again acquired major importance. This goal can also be achieved in a variety of ways. What has to be done is to select from among sector-specific and other economic policy measures that combination which will ensure that the aim is achieved at least cost to the economy as a whole, measured by cut-backs in the national product.

Finally structural policy measures can also be used for employment policy purposes, but only to the extent that the object is to reduce or to prevent unemployment caused for example by regional or sectoral distortions. These measures can, however, only be successful in the long run if they are selected according to efficiency criteria, and the new production structures subsequently prove economically efficient under competitive conditions.

92. Similarly, when regional structural policy is linked with town and country planning, its primary allocation function is in no way diminished. The overall planning policy goal of creating and maintaining equal living conditions in all parts of the federal territory means that in economically backward areas production potential must be improved and that in economically endangered areas entrepreneurial adjustment and the adaptation of manpower supply must be promoted. The question may remain open what contribution improvements in the geographic mobility of capital and labour might make towards the solution of these tasks. In many cases, specific structural policy measures may be necessary to trigger off or encourage spontaneous developments from market forces. These must then satisfy the criteria of static and dynamic efficiency. They will only be successful over the longer term if they are not used against the market forces, but exploit these in the best possible way so that geographic production structures emerge which can maintain themselves and are not dependent on permanent government support.

Indirectly, a regional structural policy oriented to efficiency criteria can also lead to a more equitable regional distribution of income. This is, however, by no means certain. Insofar as inter-regional re-distribution over and above what is done through financial equalization or the allocation of resources for the provision of certain public services, is desirable in the interest of the community, this must be regarded as one of the further aims of town and country planning. It is not a task for regional structural policy.

93. Any change in existing production structures, whether market-induced or brought about by structural policy measures, also affects the income and wealth structures in the sectors and regions concerned. The disadvantaged producers then attempt, generally with the argument about stabilizing employment, which would be in the general interest, to induce those responsible for structural policy to take counter-measures. Insofar as these measures create time for those concerned to prepare and subsequently carry out without excessive frictional losses the structural adjustment which they could not carry out unaided, they can be accepted for instance on social policy grounds, and in the case of major structural changes may even be necessary on stability grounds. But in no case must structural policy be misused to preserve economically obsolete production structures and existing income and wealth relationships.

B. Measures and Principles

94. Ex post corrections to the production structure often entail a relatively large expenditure of time and scarce resources. To keep the costs of such corrections to the economy as a whole as low as possible, it is therefore desirable to exploit to the full the possibilities of a preventive policy.

In this connection, «regulatory» policy (if. § 65) is of decisive importance. Through institutional regulations and other measures for the promotion of competition and mobility (including occupational mobility) and the maintenance of incentives in the market system, this policy promotes the capacity of the system for flexible adjustment of the production structures to changed requirements. Through other measures, such as the regulation of environment protection or state promotion of basic research, it complements from the structural policy point of view the allocation system of the market. An accumulation of ad hoc intervention in the economic process would on the other hand cause additional uncertainties and make planning more difficult for economic entities.

A preventive policy also includes measures of structural policy itself. Thus, by explaining and publicising coming structural changes (e. g. in the labour force) which may not be generally recognizable by everybody, and where appropriate also by the use of specific economic incentives, the more obvious errors in decision-making (for example choice of occupation) can be prevented and necessary adjustments (in applied research, for instance) be made in good time.

The possibilities of a preventive structural policy which can influence the production structures within such broad limits are, however, limited. Since in an open market economy system there are always new and unexpected events, structural developments can take a course which is quite different from what was forecast. A preventive structural policy designed for concrete aims must therefore be confined to preventing major undesirable developments. This makes it all the more important to have a «regulatory» policy which will enable and indeed compel the various actors involved in the market economy to take prompt preventive action.

95. Since preventive policy is not sufficient to eliminate the possibilities of structural disturbances ex post economic policy measures may be needed in individual cases. Before this is done, however, it should always be ascertained whether the disturbance is attributable to economic policy itself. Subsidies in favour of heavily urbanized areas, for example through the promotion of housing construction concentrated in these «problem regions», will cause a deterioration in the relative position of other areas and so increase their need for structural state aid. (cf. The Report by the Advisory Council of December 12, 1970 on «Entwicklung der Wohnungsmieten und geplante Maßnahmen zur Begrenzung des Mietanstiegs». Vol 7, p. 590). In such cases, phasing out measures which distort the structure facilitates the task of developing production potential in economically backward regions. Furthermore, the decision whether and if so what measures are needed makes it necessary for those responsible for economic policy to forecast for themselves what future structures and the possible effects of alternative measures to influence these structures may be. Thus, even for an ex post corrective structural policy, there is uncertainty over the assessment of economic policy problems and the selection of measures, even if to a very much smaller degree than with the preventive policy of actively influencing current structural change.

96. The inevitable uncertainty of prognoses, which is greatly increased through the large number of economic policy interventions, makes it especially difficult to take structural policy decisions in respect of individual sectors and regions. It is often very difficult to decide whether structural policy intervention is necessary at all, and if so, what combination of instruments will give the best results, and how long the intervention should last. The requirement that measures must be selected which are adequate to the goal they are to serve can invariably only be met in part.

97. Structural policy measures should not be chosen solely for their alleged suitability for fulfilling certain individual aims. They must also observe and promote the general operational conditions for a market economy. In other words, they must be compatible with the system in this functional sense.

It is especially with economic policy activities directed towards particular sectors that the criterion of compatibility with the general system is often only very inadequately observed. This is partly because the task of complying with the general operational conditions of the market economy conflicts with the aim of the producers and political agents concerned to maintain existing structures as far as possible. Equally important is the fact that it is not possible to say that certain types of instruments are generally compatible with the market order; this depends on the way in which they are applied in specific cases. Finally, another reason for the frequent failure to comply with the criterion of compatibility is that the damaging effects of intervention which is incompatible with the market order on the functioning of the system as a whole are very rarely sufficiently apparent in any particular sector. It is only with the accumulation of such intervention, each individual part of which may be «scarcely objectionable» in regard to «regulatory» policy, that the degeneration of the market economy system becomes obvious to everyone – and then it is mistakenly blamed on the system itself.

98. The criterion of compatibility with the system must therefore be observed as closely as that of suitability for achieving specific individual goals. The following principles for structural policy in a market economy may be deduced from the two criteria together:

- structural policy in a market economy must utilize the market mechanisms to the greatest possible extent;
- in cases of sectoral structural crisis or regional development distortions it should strengthen, not diminish the will to economic independence (help towards selfhelp);
- even in such cases of crises, competition must not be excluded;
- structural policy measures must comply with the principle of equal treatment;
- decisions on structural policy measures must be based on a comparison of costs and benefits for the economy as a whole or – where this is not possible – on the basis of their relative costs for the economy as a whole;
- where individual producers are given aid to facilitate structural adjustment, this must be degressive and in each case only given for a specific period of time;
- once structural policy measures have been initiated, they must be regularly and frequently reviewed and assessed to see whether they have fulfilled their intended purpose, and what side-effects they are having on the economy as a whole. The time-table for these examinations must be decided at the same time as the decision on the measure itself.

Where the State feels that it must give individual branches of industry or enterprises financial assistance especially «concealed» or indirect assistance in the form of tax relief, it seems reasonable to ask whether such measures do not imply as a necessary corollary the transfer to the State of participations rights and hence the right to participate in decision-making. If the answer is «yes», a step would have been taken which would invalidate essential elements of the market economy system. However, this can be avoided if clear rules are established as to the conditions for assistance and the corresponding obligations, together with effective administrative controls to ensure that these are complied with, in order to make certain that the aid is really only used for the purposes for which it is granted.

c. Production of Public Goods

The Efficient Production of Public Goods

Wolfram Engels

1976

A few years ago, one of the vogue words in economics was «public poverty». The proponents of this philosophy voiced the demand for higher taxes to enable the State to produce more goods and services. In the meantime, public opinion in virtually all developed countries has reversed: complaints are heard everywhere about the expansion of the State and its bureaucracy and the inefficiency of public services. The new watchwords of the day are «public waste» and «denationalization of government undertakings».

In this context, the economist is confronted by two different problems:

- The optimal division of the gross national product between private and public goods; and
- The optimal method of organizing the production of goods.

Most people today consider that the best way of financing the provision of private goods and services is to do so via prices. By contrast, the funds needed for providing public goods have to be raised in the form of special charges (i. e. taxes, fees etc.). The difference stems from the fact that public goods are not exclusive. With the exception of criminals, everyone enjoys the facilities furnished by such public services as the police force and the judicial authorities. If one were to finance such services by means of voluntary contributions, many people would decline with thanks. This is the so-called «free-rider problem». In the case of private (exclusive) goods, the problem does not arise. Anyone who orders dinner in a restaurant must pay for it. In other words, the problem of splitting up the national product amounts to this: what percentage of the overall G. N. P. should be financed via prices and what percentage via taxes (and other compulsory charges)?

The second problem – that of organization – concerns the question of whether it is better to produce in the form of markets or in the form of bureaucracies. Public discussion usually centres on the two marginal situations of raising the funds through taxation and bureaucratic production on the one hand and raising them via prices and markets on the other. Both in theory and practice, however, the greatest interest actually attaches to hybrid forms whereby certain aspects of the market are incorporated into bureaucracies, or funds are

raised via compulsory charges but nevertheless produced on the market, or else the bureaucracies themselves have to sell their goods and services.

Overproduction in the Public Sector

The optimal allocation of the national product to both the public and the private sector is an old economic problem, which has theoretically already been solved. The fundamental work on this subject was done by *Knut Wicksell* in 1896 and later modified or improved by *Lindahl*, *Samuelson*, *Musgrave*, *Malinvaud*, *Buchanan* and others. In his thesis of public destitution, *Galbraith* argued that the theoretical optimum is not achieved in modern democracies and that this is at the expense of public goods and services.

The academic debate inspired by *Galbraith's* writings came to a different conclusion: modern democracies tend towards an overproduction of public goods. The inherent interests of both public officials and politicians indicate that this must be so. Every bureaucracy has a tendency to grow. The power of the politicians increases in proportion to the State's share of the GNP (*Niskanen* and *Downs*). *Buchanan* in particular looked into the question of what results flow from a situation in which the financing of public goods diverges from the optimum economic model. Both an excessively high degree of centralization in decision-making as well as the modes of voting or the separation between the financing and producing of public goods indicate that the result will be overproduction in conjunction with a trend towards a state deficit. A study by *Oates* arrives at similar conclusions. These studies point to the assumption that the State's share of the GNP is smaller and closer to optimal when the decisions on expenditure and revenue are highly decentralized (among the Federal Government, the Länder and the local authorities), when the population itself votes directly on the procurement of public goods – i. e. direct instead of indirect democracy – and when a simultaneous decision is taken on expenditure and revenue. The nation in which reality comes closer to the optimum model, i. e. Switzerland, is also the industrialized country where the public sector accounts for the smallest part of the GNP.

However, there exists an enormous difference between the State's share of GNP and the production of public goods. The bulk of the goods produced by the State and financed via taxes are not public, but private. That holds especially true of the communes. As a survey of the activities carried out in a medium-sized city in West Germany recently revealed, the production of private goods and services by far exceeds public items. Even the consumption figures for the Federal Government and the Länder showed that these were largely private goods and services. This applied in particular to the major expenditure items «education» and «health», but also to transport, culture, supplies and agriculture etc.

This overburdening of the State with the production of private goods (and their financing via taxes) has led more and more to a situation in which the Government is failing to fulfil its real function, i. e. the production of public goods and services. Court cases are becoming not only more frequent but also more protracted (with a resultant lack of certainty as to what the law is); the crime rate continues to rise (lack of internal security); the roads are blocked because of excessive traffic; some parts of the country are less easy of access; and public indigence in the sense of an undersupply of public goods results from the overstrain on the public sector concomitant with the State's growing share of the production of private goods.

Despite the general scale of overproduction, there are regular complaints about the lack of public goods. This is not surprising. Public goods and services are normally provided free of charge. The demand is then higher than when people have to pay a price which covers costs. Let us assume as an example that the State decides to supply the whole population with motor cars free of charge. Vehicles which previously cost DM 25,000 will then suddenly be available for nothing. On the basis of the present level of production, people will soon feel there to be a general lack of such cars. When faced with this situation, the State will either

have to increase production or else to set up car-rationing offices. Indeed, this is precisely what *has* happened in many areas of governmental activity – overproduction linked to a feeling of shortage and the need for rationing (such as the *numerus clausus* for admission to West German universities).

Inefficient Production and Uncontrollable Distribution

The results of recent research into bureaucracy may be summarized in a few sentences. These are as follows:

- Bureaucracy is an appropriate form of organization whenever the decisive requirements are evenness and predictability. It is not appropriate whenever innovation and high productivity are in demand.
- The larger a bureaucracy, the smaller its efficiency.

Bureaucracy is by no means inferior to market mechanisms as a form of organization. There are a number of organizational functions which are better discharged by a bureaucracy than by markets. The mistake of recent times has been the use of bureaucratic forms even in those cases where the market would be more appropriate (i. e. in the production of goods). In consequence, bureaucracies have grown inordinately and become less effective. The market and competition are mechanisms which keep organization flexible and vigorous. Where such mechanisms are lacking – such as in the state production of goods and their financing by means of taxation – then the various organizations start to deteriorate. They lose their efficiency. This has nothing to do with the public officials themselves. Civil servants are no lazier than other people. If one were to grant a monopoly to a private enterprise and then arrange for its subsidization via public taxes, then it would produce just as inefficiently as a state authority after a very short period of time.

The justification adduced in favour of a State which produces private goods is the argument that certain items such as education and culture are so important that everyone must be enabled to afford them. This means that the production of these goods is also linked with an intention for redistribution. The simplest and most obvious concept of distribution is to take money away from the prosperous and to give it to the poor. To achieve this, there is no need for a *détour* via the zero tariff for state-produced goods. Such a *détour* is very expensive not only because it distorts the pattern of demand, but also because it conduces to inefficient production. In addition, distribution itself becomes quite uncontrollable if needy and prosperous people alike enjoy equal promotion. In that case, nobody knows who is living at whose expense! In the Federal Republic of Germany, only such students are admitted to medical studies as have obtained an average grade of 1.5 in their final school examination. It cannot be described as fair if the State presents a young man or woman (who is in any case highly gifted by nature) with a medical study worth the equivalent of two houses, whereas a less talented person gets absolutely nothing. In practice, the justificatory argument become one of the gravest charges against the state production of private goods.

The Alternatives

Niskanen sees three alternatives for overcoming this situation: improving the political system; improving the organization of bureaucracies; and a switch in bureaucratic forms of organization to a free market system.

The improvement in the political system may involve a large number of various measures such the decentralization of decision-making within the State i. e. a shift in competence from the higher to the lower level; the simultaneous adoption of resolutions on expenditure and revenue in individual cases; a precise correlation of (financial) competence and (financial)

responsibility; the creation of political instruments of decision making; and a change in the voting procedures. However, these measures are beyond the scope of the present paper.

An improvement in the organization of bureaucracies always implies incorporating certain features of market rationality within bureaucracy. One of these features would be the compulsion for bureaucracies to compete against each other. This was, for example, the basic idea behind «cultural federalism» in West Germany. The Länder were to compete against each other for the best educational system. But as the ministers of culture (similar to entrepreneurs) found competition inconvenient, it was simply eliminated and the German educational system was de facto centralized by means of the «Permanent Conference of Ministers of Culture». A similar situation exists in regard to the local authorities. Many communes were successful and became prosperous, whereas others worked less hard and remained poor. In response to this development, the rich and the poor communes were then amalgamated under the territorial reform scheme and the Länder started to even out the differences in financial resources by means of subsidies. As a result, every incentive to compete disappeared and in many instances the competitive machinery within the public administration was abandoned.

A second point would be the creating of efficiency motivation within the public administrations. As the importance of a civil servant is measured by the number of subordinates at his command, the whole ambitions of a bureaucracy focus on completing the given task with as many people as possible and incorporating as many new tasks into one's own domain as possible. Hence, the pattern of motivation favours not only achievement and thrift, but also gigantism and waste. This motivation to perform well is conceivable in many forms. In the case of public services such as the railways, the postal administration, universities, broadcasting and hospitals, the standard at performance is easily measurable i. e. a certain number of letters or parcels, the number of people listening to a broadcast and the number of cured patients etc. In other instances, one can at least determine whether or not a certain task has been completed. The solution would be to draw up a budget and then to require officials to economize. The more rationally a task is carried out, the higher will be the official's salary. Only a very small number of public sectors are genuinely closed to competition or efficiency motivation (e. g. the administration of justice).

The third set of possible solutions consists of market alternatives. They are largely applicable wherever the wish exists to keep prices below costs for certain political reasons. The pervasive atmosphere of boredom surrounding German television would soon evaporate if the payment of fees was to be made dependent on audience ratings. The general T.V. licence fee would still be charged, but stations would have to sell their products to the public. The position is similar in regard to those subsidies which depend on performance. If the Government believes that every child must have a place in kindergarten available to it, then this can be attained most easily and cheaply by paying to every (private or public) kindergarten a certain and identical subsidy per child and month subject to certain minimum standards in respect of quality. The same applies to schools. In that sector, state schools have to be forced to compete with private establishments.

A similar solution may be seen in the voucher system. Take, for example, the universities. Instead of bearing the cost of universities irrespective of their performance, the State could give students vouchers for attending certain courses. The universities would have to charge fees to cover the cost of studies and the students would pay for these with their vouchers. The universities could then cash these vouchers at government treasury offices. As a result of this procedure, the universities would have to woo their «customers», improve their performance and cut costs. By the same token, students would have to study more rationally. Once that they had used up their vouchers, they would have to finance their studies themselves. Under this system, not only students and lectures but also university administrations would be motivated to give of their best.

The return of public property to private ownership represents only one instrument in a

whole series of possibilities. Nevertheless, it offers much wider scope for action than may at first be assumed. After all, the local authorities operate everything from abattoirs and knackers' yards to market-gardens. Every major administration has its own armies of charwomen, repair workshops, computers, printing shops, refuse disposal services, road-cleaning units, bus services and many other facilities which could probably be handled more rationally by private entrepreneurs competing against each other.

The Trend towards Nationalization and Its Motive Forces

During debates on this subject, the opponents of greater market rationality – ranging from the efficiency principle in public authorities to the reprivatization of public undertakings – often arouse the impression that «genuine» state functions might well be discharged by private enterprise. However, the situation is quite different in practice. Take the example of the German postal service. In earlier times, there were few post offices but a great many subpost offices. These were restaurants or stationer's shops which carried out postal duties in return for a small payment. The postal authorities then declared the sale of postage stamps to be the prerogative of the State and promptly replaced the sub-post offices by fully fledged post offices. Another example. The printing of telephone books used to be a matter for private enterprise: now this, too, appears to belong to the State's prerogatives, as the books are printed by the postal authorities themselves. The latter also used to engage private firms for the construction of telecommunication facilities, but now they also carry out this work themselves. Presumably, the next step will be for the telephones to be made in the postal authorities' own factories. This trend may be observed in all large public bodies, corporations and communes. If at all possible, operations are handled by the authorities themselves so that the government is in fact claiming the right to implement more and more public duties. There are two mainsprings behind this: the motivation of politicians and civil servants and the country's constitutional rules governing public finances. We have already spoken about the question of motivation: the power, influence and income of politicians and civil servants vary in volume in accordance with the size of their sphere of activities.

The second mainspring is always overlooked. If a local authority commissions a private person to clean the rooms and windows of a building, then that entrepreneur must pay turnover tax, trade tax and corporation tax. If the local authority engages its own charwomen, only the wages need to be paid. The administrative costs do not come into the reckoning in any case, because the State does not have any cost accounting. As for the taxes, they do not go to the commune but to another part of the State. In short, a team of charwomen may be cheaper for the local authority (although this is often only a miscalculation), but they are in fact dearer for the State as a whole because a municipality does not pay any taxes.

In other words, the trend towards the expansion of government activities does not rest on more service for the people. It rests on the need of officials to augment their income and power and on the exploitation of one part of the State by another. As long as our motivation is fundamentally directed towards the wrong goals, the outcome will be a continuation of creeping nationalization.

Public Goods: Their Seductive Appeal and the Prisoner's Dilemma

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The theory of public goods has brought into economics a conspicuous element of collectivism which keeps spreading, and challenging the private sector. Where – in theory at least – consumers and producers used to make their decisions by themselves and to accept responsibility for the outcome, now third parties have taken the habit to intervene, as it were; they quarrel endlessly with the decisions taken, and lament that damage is forced upon society. Therefore (or so the reasoning would go) society ought to control – if not direct – private decisions makers. As the individual had proved unable to meet his responsibility by himself, the critics would argue, society had to step forward and then naturally take part in the decisions.

I. Erosion or Extension of the Social Market Economy?

In fact, certain features of public goods prove ubiquitous if one only takes a close look. «Pure private goods», in theory the absolute norm hitherto and indispensable for the market's functioning, all of a sudden turn out to have shrunk to a «knife-edge of reality».¹ Since the market mechanism is bound to fail whenever elements of public goods are encountered, this means that the market itself remains nowhere unchallenged.

In such a situation, anyone wishing to maintain the viability of market economies would be ill-advised if he were to simply look away or to retreat in a defensive manner whenever running into the problem of public goods. Quite the contrary. He must focus his attention on this very problem; and he will then discover that it is society itself (acting through government) who is not maintaining and improving, but continuously abolishing the institutional prerequisites that must be met in the first place if individuals are to act in a responsible manner.²

To provide the individual with some leeway for independent and self-responsible

decision, it would traditionally suffice to keep the configurations of economic power balanced by means of competition; but that is not enough anymore. We must ask ourselves, what are the general conditions under which a life of individual responsibility is at all possible in a modern economy? And how can be safeguarded? In violating such conditions so glaringly, public goods have opened our eyes to the fact that such conditions are quite precarious and highly susceptible to outside manipulation, and that this poses a latent threat to individual freedom within modern economies. But the very same public goods have also provided us with a clearer view of the many opportunities which do exist to preserve the conditions just mentioned. Unfortunately, to exploit them one has got to use unconventional strategies which cannot easily be put into practice in political terms.

In brief, we shall argue in this paper that we cannot simply leave the social market economy as it stands. It must either be expanded into the domain of public goods; or otherwise it will erode to the point of becoming meaningless.

II. Private Goods and the Invisible Hand of the Market

Before studying market failure due to public goods, let us have a closer look at the familiar terrain of conventional, «pure» private goods. Such goods, loaves of bread or fur caps say, are supplied in separate pieces, each of which may be individually purchased and then exclusively consumed. We shall find that even here the problem of public goods is present, concealed right under the surface. Hence, the problem is not at all a new one: we have simply grown accustomed to overlook it. Why? Because it was well solved. There was simply no point in watching out for the problem now at hand.

1. Scarcity and Economic Responsibility

Just to get a fresh view, let us ignore the solution and view the problem in the way a man from Mars might do. It then appears highly intractable, and the solution surprising.

(1) The commodity (a loaf of bread for example) must be produced in the first place; and that implies that factors of production must be withdrawn from other productive uses. The loaf is thus obtained at the price of forgoing other items that cannot be supplied anymore. This renunciation we term the social cost of producing a loaf of bread.

Who is responsible for such cost? Solely the bread's consumer: it was but his wish for bread that made it necessary to forgo other items. To live up to his responsibility, the bread's consumer would have to renounce himself in return for each loaf consumed, an equivalent to the items that must be forgone to produce a loaf; i. e., he must meet the marginal social cost. In so doing, the consumer would merely return to the economy what he is taking away from it in the first place by requesting the loaf; and he would thus avoid satisfying his own personal wants at the expense of the general public.

(2) There is yet another aspect to this matter. Due to general scarcity, not all wishes can be satisfied at a time. Once the commodity is produced, it is always in short supply; and there are always more would-be consumers than can actually be served.

Consider one given loaf of bread. Several potential consumers are competing for it, but just one will get it. Knowingly or not, he takes it away from others, and the economic responsibility for taking it rests with him. To meet such responsibility, he would have to deposit the shadow price of bread which consists of the sacrifice asked from another customer who also wanted the loaf but could not get hold of it.³ Yet how can the taker comply if the loser's needs are unknown to him? Strictly speaking, what we are requiring from the taker is to weigh his own wishes against those of competing customers, and then to go ahead only after making sure that his is truly the most urgent desire. Even worse: the losers must agree with him!

If each and every consumer behaved thus, then the total claim would never exceed available stocks, and the supply would always go to those who needed it most. There would

be no reason for any authority to intervene. Nobody would have to parcel out rations for customers, because the latter would prove mature and self-responsible citizens.

2. Futile Virtues, Or Why People Act Irresponsibly

But of course such a consumer doesn't exist. Real-life consumers like you and me would shrug off the idea that they themselves could ever act this way (although, as we shall see, they quite often do). In reality, the consumer is by no means carried away by a keen sense of economic responsibility; instead, he is still our old friend *Adam* who would not take such responsibilities too seriously. And he would certainly not be willing to forgo the gratification of his own wants, just to give his neighbor a better life. Apart from rare exceptions, we had better accept him to be a complete egoist who pursues his own interests only.

Given that the consumer fails to prove mature and self-responsible in the way we required him, should he not be put under tutelage? If he doesn't restrict himself, isn't the government to restrict his endless claims?

It is in fact not easy to see how this could ever be avoided. But then, why so much irresponsibility? To understand this, let us place ourselves in the position of someone who would indeed try to behave as required above. We shall then immediately see why real-world consumers would not even dream of behaving this way.

Consider a very simple case which is characteristic though of everyday economic situations. Suppose all loaves but one of the going kind of bread have been allocated, so just this one is still available. A number of would-be customers turn up and we must decide who is to get the loaf. Surely it would have to be the one with the most urgent need. But then, to find out just who that is, we must answer questions which are raised a billion times each day as a matter of economic routine:

- Which want is the most urgent?
- How do we identify its bearer among all the rest?

(1) Unlike times of hunger when it is possible to provide objective criteria with regard to our need for calories, proteins, minerals etc., our wants are largely subjective in nature. In principle, we cannot quantify them because there is no way to tell why the various would-be customers want the bread, and whose sacrifice carries more weight. One of them may rank bread slightly above potatoes, to which he must however resort if he cannot get hold of the bread. Another may prefer this going kind of bread simply because the man next door does the same; and he would experience a loss in prestige if he had to come to terms with another kind. Who deserves the bread, judged in objective terms? In the end, there is no answer to this question. We need a measure in order to weigh various wants against one another; and there exist an infinite number of plausible measures.

This by the way implies that social costs and shadow prices – which account for renunciations of would-be consumers – are themselves subjective in nature and cannot be determined «objectively». Moreover, it is impossible to rank «objectively» the needs of different men according to urgency of needs.

(2) But suppose we had agreed on a yardstick after all; then, we are still in deep trouble. As a matter of principle, we may now go ahead and weigh all those needs of various people against one another; we could file rank orders of needs, then find out which one of the various needs for that single loaf of bread ranks highest, and eventually hand out to its bearer the loaf.

Yet this cannot be done in practice. We would have to know precisely all individual wishes of each and every consumer to proceed this way; but given that we cannot look into individual thinking and feeling, we must rely on what the individuals tell us. That, however, would request perfect honesty from everyone.

(3) But why should anyone agree to be perfectly honest? He would be foolish if he so agreed:

- It would be in accordance with everyone's interest if each would-be consumer were to

declare not just his wishes, but also his willingness to compromise. He ought to point out second-best and third-best solutions, as it were, just in case he cannot get what his best wishes are. For example, he might confess that – while really fond of the going kind of bread – he could agree to another kind as well. Or maybe he would certainly like a car; but a bike would be fine with him if the car should prove difficult to supply.

- But that would be a poor strategy for him to pursue. Why should he waive his claim for his favorite kind of bread as long such kind is still in stock? And why should he resign himself to a bike when there are cars available?

- The individual consumer might even consider to behave perfectly honest, and to follow the strategy just outlined – if he were only satisfied that everybody else would do the same. Because in that case, he would know that he himself would have a good chance to get the items he wants badly, as others would then acknowledge his urgent desire and step back themselves. But how can he find out whether or not it is left for him alone to behave foolishly enough, restricting himself while nobody else will? He listens to his neighbours who claim that their professed needs are very urgent indeed. But can they be trusted? Maybe they are simply bluffing? Maybe they are not as self-critical as he himself was just pondering to be? Maybe that those professed «urgent» needs are in fact mere whims? There just isn't a way for the would-be consumer to tell.

(4) Every single would-be consumer would share the very same suspicions. Nobody would know what to make of his neighbour's assertions – and everybody would eventually conclude that it would be safer to take the professed needs of others with a grain of salt, and to blow up his own needs a little. As everyone would thus be inflating his claims, no declaration could be taken at face value anymore – however true it might in fact be. But at this point, all suspicions of our would-be consumer would have proven perfectly justified; and he would therefore congratulate himself not to have been foolish enough to believe anyone's claims, and to restrict his own wishes.

In conclusion, it appears that you cannot allocate the scarce resources of an economy by just leaving it to the individuals to restrict themselves. Yet if the individuals won't do so, then the authorities must step in. And they cannot, of course, know any better just what the individual consumers really want, given that everybody keeps inflating his own claims. Hence, all they can do is to turn out prefabricated planning schemes; and these are invariably grey and dull. You simply cannot avoid that because it is no longer the consumers themselves who determine what they want, but some anonymous bureaucrats planning away along abstract lines. Now the consumer is indeed put completely under tutelage; and apparently this result cannot be escaped because no individual consumer will live up to the wide measure of personal responsibility which arises from the general scarcity of national resources.

3. The Prisoner's Dilemma

(1) This outcome appears virtually inevitable. It is all the more surprising, then, to find that our normal life is so comfortably divergent in nature from the above scenario. The problem lends itself to an unexpected solution, as we all know from personal experience. But just how far such solution is from being self-evident may be seen from routine examples from sectors where the solution is not applied.

- Whenever people start queuing for something in a centrally planned economy, passers-by will immediately join the queue even though not even aware of the items available. They assume that whatever it is will be of some use. But in so doing, they snap away the scarce item from others who are in bad need for it. Therefore, the government cannot resort all too often to such «free» method of distribution; or otherwise it must realize that people waste a major part of their time and energy standing in queues instead of devoting such time and energy to the production of scarce goods.

- The steady expansion of public activities may be ascribed in no small measure to this same dilemma. As the government's budget is being prepared, every ministry works hard to

increase its own share of the funds. To bolster its chances, it will readily spend its energy supplying arguments and «proof» of acute public need for precisely the expansions that it has in mind. And while the Minister of Finance works equally hard to cut back fresh claims to some reasonable level, this absorbs so much energy that he must restrict himself from the beginning to negotiate increments rather than the total volume of expenditure. Thus expenditures are bound to keep growing, even when the needs for them diminish.

- Another reason for the persistent growth in government expenditure is that Congressmen are themselves subject to the same dilemma. Each of them must provide special advantages to his own constituency back home; but it would be of general benefit if he were to restrain his demands. And since nobody knows the background equally well, he should even propose himself cuts in programs that were approved in former years! But that of course would earn him bad feelings from his constituency – and to some extent rightly so, since all other Representatives behave precisely as their respective constituents expect them to do.

(2) In all these instances, the same dilemma is involved which induces a collective sense of irresponsibility if it cannot be resolved. The dilemma confronts each individual with a choice that grossly overtakes his personal strength:

- If he acts in the interest of the general public, this will be to his own immediate disadvantage;
- if he follows his own interest, he will realize some immediate personal benefit, but at the same time harm the public interest and eventually himself;
- even if he should ignore his own personal benefit and act entirely in the public interest, this would not be of help because his own personal contribution carries little weight;
- the dilemma could be overcome only if everybody were to disregard his own immediate advantage and, instead, promote the public interest; but since everybody distrusts everybody else, this outcome just won't happen.

(3) The problem of public goods consists, by the way, in precisely this dilemma; and we have thus met the problem even before introducing public goods altogether. As we have seen, the dilemma is hard to avoid as soon as private wishes compete for scarce goods. Such scarcity, however, is the very essence of economic problems; and hence the dilemma is lurking around wherever we choose to settle in the field of economics.

(4) The dilemma has got its name from the theory of games. Suppose several prisoners are accused to have jointly committed a murder. The District Attorney, who is up for reelection, cannot prove it and needs their confessions. To get them, he separates the prisoners from each other so that they cannot communicate; and then he makes this offer to each of them:

- If one man denies the charge but someone else confesses, he will be treated as convicted by state's evidence and sentenced for life;
- if he confesses among others, his cooperation will be rewarded by the minimum sentence of five years;
- if he is the only one to confess, he will be set free immediately for turning in state's evidence.

It is this offer that confronts the prisoners with the dilemma. Of course, it would be their common interest to deny. As the D. A. cannot prove a thing, he cannot but set them free! But whoever denied the charge would face the immediate risk of a lifetime sentence; and even worse, he would not help anybody, as just a single confession would suffice to convict them all, and someone else would confess anyway. On the other hand, if the prisoner were to confess, this would carry a maximum sentence of five years, and he might even be set free tomorrow. Unfortunately, however, they would all be set free if they only kept denying the charge. But the risk is simply too high; and so all confess. This outcome is quite independent of the facts: the prisoners will confess even when they are perfectly innocent. Faced with the prisoner's dilemma, they will all sacrifice their common interest. They cannot dare to act otherwise – except of course when they feel confident that nobody will confess. But that is a different story which we need not here.⁴

(5) Our example depicts an extraordinary situation. Nevertheless, our everyday experience confronts us with the prisoner's dilemma again and again:

- Where it is necessary for the functioning of economies that everyone declare in perfect honesty his true wants, everyone will exaggerate his needs and thereby force the government to resort to strict planning;
- where in such a planned economy, scarce items happen to be sold on the free market, passers-by will immediately queue up for them even when not really interested in the items sold – and they will thereby force the authorities to abandon further attempts at relaxing the strict rationing;
- where bureaucrats and Representatives are the competent ones to point out opportunities of saving money in the process of preparing the budget, they will in fact raise even more claims and thus inflate the volume of public expenditure.

In all these cases, it should be stressed that not the individual is to be blamed, but the institutional set-up which allows the prisoner's dilemma to show up. Once caught in the dilemma, nobody is strong enough to escape it.⁵

4. The Secret of the «Invisible Hand»

The prisoner's dilemma will absolutely destroy the necessary conditions that must be met if individuals are to make independent and self-responsible decisions and thus to develop as free members of society. These conditions are fragile enough: all competition among individuals for scarce goods tends to produce the prisoner's dilemma – which is, as we have seen, inherent in any such competition, wherever it may occur. To cope with the latent dilemma, very sophisticated institutional safeguards are needed – a fact that keeps escaping the attention of politicians.⁶ Yet as soon as such safeguards begin to lose their efficacy, the individual is plunged into the dilemma again, which then drives him into a spirit of collective irresponsibility.

What are the institutional safeguards required to counteract the dilemma? It is here that the institution of the market proves its ingenuity; a market economy will enable the individual to meet his economic responsibility, and achieve a life in freedom, amidst a society full of interdependencies and economic constraints.

How is this possible? The «invisible hand» of the market outwits old *Adam*. It does so by using, of all things, precisely his keen sense of self-interest in order to make him act responsibly in an economic sense. Let us return to those would-be consumers of bread, and see what happens.

- Each loaf which the «taker» consumes imposes marginal social costs on the economy. But then, the price he must pay in return will cover exactly these costs; and if he wishes to or not, he cannot but renounce himself the supply that must be forgone to produce the loaf.
- He does take away the loaf from other would-be consumers. But since he deposits the shadow price of bread at the same time (in paying the market price), he meets in fact the sacrifice asked from the potential (but unsuccessful) consumer who needed the loaf most badly. And the latter, in not buying the loaf himself, concedes that the buyer's wants are more urgent than his own. When considering whether or not to pay the price, each would-be consumer weighs his own wants against those of other competing consumers; and when he finds that his are less urgent than theirs, then he steps back – because he feels that the loaf costs too much.

Why, then, does he not bluff as usual, why not blow up his own claims? He would be foolish to do so. If he did, he would have to purchase more bread than he would deem worthwhile himself; and he would thus overspend on bread – only to find that not enough money were left for other items which he would also like to consume. Hence, under the circumstances, it pays for him to articulate his own wants with precisely the self-restraint that is required if he is to meet his economic responsibility.

5. Objections

(1) The consumer's willingness to pay a price for some item he wants depends not merely on the intensity of his need, but also on his purchasing power. This constitutes a source of annoyance for many critics of the market economy: those who find the prevailing distribution unfair will see this unfairness reflected in market results.

However, as we have seen there is no such thing as «objective» wants. To weigh one against the other, a yardstick is needed which invariably entails an arbitrary element. The market's yardstick, as it were, is the prevailing distribution of purchasing power. You receive purchasing power as a compensation for the services that you supply, and according to the value that others put on those services. If, then, such purchasing power were to prove meaningless because not honored on the market, you would become quite reluctant to provide further services.

The «social market economy» relaxes somewhat the rigid relationship between services supplied and purchasing power received. The market is thereby placed within a social framework which is politically determined. The higher the guaranteed minimum income, the less relevant becomes the criticism that the weaker ones are pushed around in the market economy; but, at the same time, incentives to work hard are reduced. If one is not very careful, the prisoner's dilemma is unleashed again: as your standard of living becomes sufficiently independent of your own commitment to work, it will not pay anymore to forgo leisure; and the result will be that nobody works hard, and all suffer from a poor supply of commodities.

The worst thing to do, however, would be to abandon the market economy altogether just because one does not like its «unfair» results. For, in that case, the institutional safeguards which protect individuals against the prisoner's dilemma are deliberately suspended; and what one then gets is simply the rough and bleak situation observed in socialist economies, which results from nothing but failure to cope with the prisoner's dilemma.

(2) Many reservations stem from the phenomenon of market power as a source of «unfair» market results. The market works correctly as long as market prices are shadow prices, i. e., as long as they reflect social marginal costs. The monopolist will, however, curtail his supply and thereby raise the market price far above the correct level; and this enables him to derive some illegitimate extra income, the «monopoly rent», from his wrongdoing.

In fact, this reflects a deficiency of the market's invisible hand, which calls for additional institutional safeguards. We shall not pursue this matter here as this has been treated in some detail elsewhere⁷.

III. Pure and Impure Public Goods⁸

(1) Let us now turn to public goods themselves. We may do this quite cursorily as the problem of public goods is now familiar to us. The «pure» public good is one that cannot be parcelled out to individuals at all, but which must be consumed jointly. Its quality is independent of the number of consumers: once produced, it is available to all; so it makes no difference whether ten or a million people enjoy it. Therefore, each individual consumer takes nothing away from others by joining the crowd; and the single consumption act carries a shadow price of zero. On the other hand, the good must be produced, and the marginal cost of production will be quite high. The standard example is public defense: once effective, it protects you regardless of your individual contribution; but since it must be provided on a large scale, it is a very expensive thing to produce.

How much, then, should the individual pay for his participation in the consumption of a pure public good? Precisely the amount he is willing to. The question must be put this way: just how much of the good should be supplied to all? To get the answer, let us suppose you start supplying very little of the good.

Then, people would like more of it and would accordingly be prepared to pay an appropriate sum in return. The total sum would probably cover more than an additional unit of supply would cost to produce; and, consequently, supply should be scaled up. This should be continued up to the point where the sum of individual contributions equalled the marginal cost of supplying another unit. At this point, individuals are willing to pay precisely what it costs to provide another unit; as a collective, they are prepared to meet the economic responsibility that comes with demanding provision of the public good.

Unfortunately, this point will never be reached; and this is due to the prisoner's dilemma which comes into the open in a spectacular way here. As there are so many consumers involved, the individual's share is negligible. In view of the total sum to be collected it makes no difference whether you pay your personal share or not. Why, then, should you pay at all? You could just as well throw your money out of the window – the effect is nil. But this puts everybody squarely within the prisoner's dilemma: nobody will act in the common interest at all, nobody will pay a dime; and all will suffer from an insufficient supply of public goods.

(2) Obviously, the «pure» public good is a rare specimen. Much more significant are goods that combine elements of pure public goods with elements of pure private goods. An important example is provided by «externality».

Broadly speaking, externality is present whenever the market price of some good covers less than its true marginal cost². Then, there is a divergency between the two, which means that individuals meet their economic responsibility only in part, and that they do not entirely offset the full social cost of the goods supplied to them.

As an example, take the noise made by a car that passes by your house. It takes away some of the quietness that you would otherwise enjoy; and this constitutes an element of social cost. But the driver himself is not being confronted with this particular social cost, for which he is however responsible; it is not he himself, but you who forgoes quietness as a result of his driving a car. – On the other hand, just like men complaining about the noise, you might start your own car to get some beer. And sure enough, one of the men now complaining about the noise of your car is – the one who was just passing by your home.

Obviously, it would be in the common interest if all cars were equipped with noise-abating devices. But, here again, nobody will comply due to the prisoner's dilemma. Because if you spent all that money to have the device built into your car, that would not help you a bit: you would still suffer the noise of other cars as before, while nobody would really notice that the general noise level is somewhat reduced by your own noise-abatement. Consequently, the device will not be introduced, and all will suffer from undue noise.

(3) Some public goods may be called «impure» in that they are to be consumed jointly by many, but their capacity is nevertheless limited. Such goods are «purely public» so long as few consumers use them; but they become «private» when sufficiently frequented: each additional consumer will then take away some of the cake from others and bear responsibility for the sacrifice others must face.

A bridge provides an excellent example. If you cross it during the night, there will be no social cost involved (we disregard maintenance cost etc.). But if you insist upon using it during rush hours, then your car will add to general congestion. Your decision to cross the bridge now imposes social cost on others who must wait longer to get home. Again, it is they who must bear such loss of time due to your decision; and you suffer a time loss yourself, due to their decisions. Not one of you considers the losses he is inflicting on others; and in the end, all traffic breaks down as you are all caught in a traffic jam.

The prisoner's dilemma is at the heart of this situation once more. If you faced the social cost of your crossing the bridge now, it might add up to some hundred dollars. As a responsible citizen, you would probably find that too much, and cancel the trip. But the only effect would be that you stay around the parking lot while the traffic breaks down anyway. Your own contribution is so minuscule that it does not count at all; and therefore

you may as well go ahead and try to get over with it. But since everybody acts as you, all end up losing an hour or two trying to get home during rush hours.

(5) What can we do to resolve deadlocks like these, besides giving in to sheer authority, i. e. besides regulating every detail in a bureaucratic manner? The situation is hopeless when pure public goods are involved: here indeed the government must step in, raise taxes and use the proceeds to buy military equipment. But as we saw, pure public goods are rare. And the closer we get to «private» goods, the better our chances are to substitute market elements for direct government regulation.

Take externality in the environment, for example. When people pollute the air, this constitutes a social factor not accounted for by polluters. Why not, then, let them pay for those costs? To achieve this, issue a limited number of regional «rights to pollute» and auction them off to would-be polluters. If the only way to pollute lawfully is to obtain the corresponding rights, then such a right will command a price equal to its shadow price, which will account for the loss inflicted upon other would-be polluters who cannot get hold of such a right, due to their limited number¹⁹.

With regard to the bridge during traffic hours, why not auction off hourly «rights to cross» among would-be commuters? The toll would become high during rush hours, much lower thereafter, and even zero over night; and that would induce many to reconsider their time schedules.

We have now considered a few examples of situations where economic activities bypass the market and thereby lead clearly into a prisoner's dilemma. There are many more such situations, and their importance keeps growing: the more tightly economic interactions become, the more externality and the more congestion will result. This means that an erosion of the market economy is taking place which we must counteract if we are to secure the institutional safeguard that the market provides against the prisoner's dilemma, or the «problem of public goods», as we may now say. The alternative to accepting such erosion is to spread the market into fields where we are not used to see it in operation. If we fail to start putting this into practice, however, then we shall see the market losing its grip and gradually approaching a point of no significance.

IV. On the Growing Degree of Publicness of Our Economy

1. The «Publicness» of Goods is a Gradual Attribute

As we saw, the prisoner's dilemma is concealed right under the surface of all situations where individuals compete for scarce goods. In other words, it is inherent in all economic patterns. Wherever we must put up with scarcity, there is the possibility that the individuals' personal interests collide with the public interest. To the extent that such a clash is not defused by means of adequate institutional safeguards, the individual is then tempted in an irresistible manner to disregard the social cost of his actions; he will thereby divest himself of his economic responsibility, and find himself deprived of this sovereignty in the end, being subjected to impersonal and colorless ruling and rationing through distant bureaucrats.

We have also seen that the market will serve as an institutional safeguard against the prisoner's dilemma, provided that scarce goods are private in nature, i. e., suited for exclusive individual consumption. It is then possible to outwit individuals for their own good: their very selfishness will induce them to come to terms with their economic responsibility, and to act in conformity with the public interest.

This capacity of markets is completely lost when goods are purely public; and then the ever-latent prisoner's dilemma shows up fully again. Market failure is incomplete, though, if not pure but impure public goods are involved. Since very single good obtains some publicness, as soon as just a little externality turns up²⁰, nearly all goods are in fact partially public; and market failure will therefore be a gradual phenomenon. The public element may

be marked, *e. g.* when externality is quite prominent; and then market failure may approach that for pure public goods. On the other hand, externality may be virtually absent. Then, the good will be «purely private» for all practical purposes.

Thus, there is not much point in talking of «public» versus «private» goods. We should rather indicate the «degree of publicness» of any given good. If a good exhibits a marked degree of publicness, then private and public interest will clash severely: the market will fail to a substantial degree. Vice versa, when the degree of publicness is moderate, then the collision of private and public interest will prove slight, and the market will work out satisfactorily¹².

A marked degree of publicness will be indicated by these symptoms:

- The benefits of acting responsibly will be scattered all over the economy, and thus go virtually unnoticed for any individual;
- the costs of so acting, by contrast, will be immediately felt by the agent himself;
- even if the individual were to act responsibly, his isolated benevolency would not be of much help to anybody as long as the others (or at least most of them) did not follow up his example instantaneously;
- but as nobody wishes to expose himself to the immediate costs of acting responsibly with the benefits remaining uncertain, no one will live up to his economic responsibility and act according to the common interest;
- hence, all will disregard the social cost imposed on others, violate the common interest – and see that their collective irresponsibility cannot but trigger heavy-handed state interventions which will severely restrict their personal freedom of action.

Hence, the higher the degree of economic activities, the more difficult it becomes to behave in a sensible manner, and the more oppressive government restrictions will have to be.

2. Changing the Degree of Publicness Through Administration

Up to now, we have treated the «publicness» of any given economic activity as if it were a «natural» attribute, *i. e.* something technically inherent in such activity. If that were true, then we would have to register a «law» of rising publicness within modern economies. As more and more externalities are being generated in the process of intensifying the division of labour, and as congestion of public facilities becomes more and more prominent, our economy simply could not get around experiencing a sharp increase in its degree of publicness. And that, in turn, would mean that we could not escape a fate of tight regulation everywhere, of a public sector whose growth could not be halted, and of an ever-present bureaucracy that would strangle, piece by piece, the opportunities for private enterprise.

But in fact, the degree of publicness depends largely on the institutional set-up. Externality, for instance, may be «internalized» by means of arrangements that confront economic agents with the full social cost of their decisions. To the degree this is accomplished, an activity that was formerly quite «public» will become virtually «private» in nature, in that its degree of publicness is reduced close to zero. It must therefore be one of the chief aims of economic policies to find ways and means of halting the growing «publicness», and expanding the «privateness» of our economy.

3. The Growing Publicness of the Private Sector

But this is not what happens. Quite the contrary: the government is busily modifying the institutional framework of the economy in such a way that its degree of publicness gets inflated, not reduced. We even witness the disturbing spectacle of goods becoming «public» – *i. e.*, coming to exhibit a marked degree of publicness –, which are purely private by all familiar definitions¹³.

Now this sounds strange, if not impossible. How can you get a pure private good – bread, say – to exhibit all the negative characteristics of the pure public good?

There is one property of pure public goods which proves irresistible to egalitarians, seducing them to force the same property upon goods that are purely private in nature. The result is that such goods assume not just the desired feature, but the negative features of public goods as well: the market loses its capacity to avert the prisoner's dilemma; and thus people get hopelessly trapped within the problem of public goods.

The property we are talking about is equality. The benefits of a pure public good are shared among all consumers, regardless of their willingness and ability to pay. It is easy to lend this property to pure private goods as well: just give them away free of cost to everybody, and you immediately get an exceedingly high degree of publicness. Why is this? As the provision of the good is detached from the requirement of paying a price, the market is robbed of the very means by which to outwit the old Adam. Consequently, old Adam becomes subject to the prisoner's dilemma, and the provision of the good will have to be made public.

(1) Let us illustrate this process by means of our former example, bread, which is a pure private good. Suppose that bread is no longer sold on the market but given away free of charge, with the costs of production covered by the proceeds of a «bread tax» raised from everybody¹⁴.

The production of bread involves marginal social cost which will increase as the volume of production goes up; and responsibility for such cost rests with each consumer. But the consumer is now unable to meet his responsibility. One reason is that he does not know the true social cost anymore. The other and decisive reason is that, even if perfectly aware of such cost, he still gets caught in the prisoner's dilemma:

- If he were to deliberately restrict his own consumption to the point where his marginal willingness to pay were to cover marginal costs – a highly abstract line of reasoning to him under the circumstances stated, that would amount to a voluntary renunciation in view of apparently unlimited supplies.
- The «bread tax» – depending not on his own but on total bread consumption – would show no sign of declining in response to his own renunciation; and he would therefore get all the disadvantages but no advantage whatsoever from his benevolence.
- As a result, everybody will expand his own consumption of bread. But since bread is expensive and since marginal costs are still rising given the increased volume of production, there will be a «cost explosion»: the «bread tax» will keep moving up, which everybody hates to see; but everybody keeps pushing it up even further.
- Public annoyance with the overwhelming cost of bread will force legislators to do something about it. Unwilling as they are by assumption to ask prices in return for bread, all they can do is to issue fixed limits with regard to the quantity and quality of individual portions; and this will artificially introduce precisely the rigidity of individual allotments which is causing market failure in case of pure public goods.
- Paralleling this policy of curtailing the demand for bread, the supply side will also be regulated. Incomes of bread producers and wheat farmers will undergo much scrutiny through government agencies, because they will have grown very high. As would-be consumers need not keep a critical eye on the price of bread (due to its free delivery) Government must step in and substitute for the scrutiny of markets.

All this, by the way, can be observed in great detail these days in West Germany's public health sector.

(2) The high degree of publicness of a pure public good yields a supply which is far too short given the consumers' real wants. To the individual, the quantity he gets is fixed independently of the price paid. It is to his personal advantage, then, to become a «free rider» by paying the minimum – nothing at all. Since the proceeds so obtained are minimal, not very much can be produced on a voluntary basis.

A high degree of publicness of a pure private good will yield the opposite result: a supply far exceeding the consumers' real wants. Now it is not the quantity that gets fixed, but the

price – the «bread tax», as it were. The sum thus to be paid by the individual is fixed independently of what the consumer actually demands, and «free-riding» will then take the form of consuming much. The result is a collective feeling that more and more should be given by the Government – free of cost, naturally. At the same time, everybody will deplore high taxes, and rightly so; yet to get out of the situation turns out to be exceedingly difficult as everybody is trapped within a prisoner's dilemma.

(3) Such a tendency is reinforced (in West Germany, that is) by numerous laws – enacted with all the best intentions, but marked by wishful thinking –, which lead those concerned into a bad prisoner's dilemma:

- If employment of the elderly is to be secured by means of impeding their dismissal, then the very opposite is in fact accomplished: firms stop hiring older staff altogether. Whoever conformed with the law's intentions by taking on older men and women would suffer loss of flexibility, and thereby incur grave economic handicaps.
- If families are to be protected by granting employed mothers their net salaries or wages for six months following birth, then those mothers are in fact punished who give up their occupation to devote all their time and energy to the family and the kids. This runs completely foul of the legislators' intentions. The number of employed mothers will increase, and families be neglected more than they used to.
- If the university system is to be opened to everybody by giving access to it free of charge and by lowering admission standards, then it will in fact get jammed and inaccessible to all. The system is turned into an impure public good and thus made susceptible to congestion; its capacity to furnish top qualifications is spoiled. In addition, the congested system makes it necessary to curtail the time available to each student, to standardize curricula, and to bar any switch of the subject being studied. The latter point will in effect punish the students' intellectual curiosity which is, however, in the basis of all academic work.

Summing up, we find that there is a broad tendency to expand the public sector even more; and on top of this, to inflate the degree of publicness of the remaining private sector.

V. Conclusion

The problem of public goods is latent even amidst the economy's private sector. As long as goods are private in nature, the problem may be neutralized with the help of the market; but the market's capacity of doing so depends itself on precarious institutional premises which are stubbornly eroded through governments.

Irrespective of this, the importance of impure public goods is steadily growing due to a more refined division of labor, and to an agglomeration of vast industrial activities. But this development is not inevitable. It can be curbed, and even reversed, by means of institutional change.

This would call for an expansion of the market economy into the traditional public sector. Such an expansion is exceedingly difficult to accomplish in political terms. Yet if we fail to go ahead and to start working on it, then we shall see the economy's degree of publicness rising on and on; and this in turn would make it hard – and even impossible in the long run – for the individual to live a free life as a responsible citizen within the modern economy.

1 P. A. Samuelson, «Pure Theory of Public Expenditure and Taxation», in: J. Margolis and H. Guitton (Eds.), *Public Economics: An Analysis of Public Production and Consumption and Their Relations to the Private Sector*. Proceedings of a Conference held by the International Economic Association, London 1969.

2 See H. Bonus, «Ordnungspolitische Aspekte öffentlicher Güter», in: E. Helmstädter (Ed.), *Neuere Entwicklungen in den Wirtschaftswissenschaften*. H. Bonus, «Verzauberte Dörfer, oder: Solidarität, Ungleichheit und Zwang», *Ordo* 29 (1978), 49–82.

- 3 In general, more than just two would-be consumers compete for the loaf. Then, among all «losers» it is the one who wanted the loaf most badly, who must be accounted for by the «taker».
- 4 The Mafia will kill everybody who confesses in such a situation; and as each member is aware of this, nobody will confess. This means that all will be set free. In economics, solidarity serves the same purpose. For details, see: *H. Bonus*, «Verzauberte Dörfer, oder: Solidarität, Ungleichheit und Zwang», loc. cit.; especially, pp. 60–64.
- 5 Relaxing the principle of balanced budgets in the wake of Keynesian economics has in fact exposed Representatives and bureaucrats more deeply to the prisoner's dilemma, thus causing them to explode the state's share of the GNP. See *J. M. Buchanan* and *R. E. Wagner*, *Democracy in Deficit – The Political Legacy of Lord Keynes*, New York etc. 1977.
- 6 See *H. Bonus*, «Von der unsichtbaren zur öffentlichen Hand», *Frankfurter Allgemeine Zeitung*, Sept. 23, 1978.
- 7 See *H. Bonus*, «Verzauberte Dörfer, oder: Solidarität, Ungleichheit und Zwang», loc. cit.
- 8 The following parts of the original paper are abridged in the English version. They are more formally treated in a later paper: *H. Bonus*, «Öffentliche Güter und der Öffentlichkeitsgrad von Gütern», *Zeitschrift für die gesamte Staatswissenschaft* (1980), pp. 50–81, where more literature is quoted, too.
- 9 We are confining ourselves to Pareto relevant negative externality. See *J. M. Buchanan* and *W. M. Craig Stubblebine*, «Externality», *Economica* N. S. 29 (1962), pp. 371–84.
- 10 *J. H. Dales*, *Pollution, Property, and Prices*, Toronto 1968, See also: *H. Bonus*, «Über Schattenpreise von Umweltressourcen», *Jahrbuch für Sozialwissenschaft* 23 (1973), pp. 342–54.
- 11 This is the definition brought forward by *P. A. Samuelson*, «Pure Theory of Public Expenditure and Taxation», loc. cit.
- 12 For a formal derivation of the degree of publicness from the theory of public goods, see *H. Bonus*, «Öffentliche Güter und der Öffentlichkeitsgrad von Gütern», loc. cit.
- 13 Technically, pure private goods exhibit no externality. They may acquire, however «indirect externality», which is the dual of «direct» externality. See *H. Bonus*, «Öffentliche Güter und der Öffentlichkeitsgrad von Gütern», loc. cit.
- 14 For a fairy-tale on this subject, see *H. Bonus*, «Ordnungspolitische Aspekte öffentlicher Güter», loc. cit.

Supplement

The Theory of Public Economy in the Present Age

Horst Claus Recktenwald

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Since the two world wars, the nature of political and economic life as well as the scale of social and technical advances have changed so fundamentally as to impart a significance to the scope and content of governmental functions, which is truly historic for peacetime.

These shifts in what the State does are apparently occurring faster than how it carries them out. The governmental activities of the last few decades have been marked by worldwide tension between the Eastern and Western social and economic systems, which has sometimes reached such a level as to have promoted considerably the arms sector in the widest sense of the term (including space travel) and public research. At the same time, the former colonial nations have been pressing for political and economic emancipation. Within our own country, the traditional governmental functions and the social and economic assistance provided by the State have assumed patterns and forms which nobody could have foreseen. This deep-rooted transformation rests on a process of democratization and decentralization which is still continuing in nearly all sectors. But just how many benefits the pluralism of our modern society affords, both in the private and public spheres, and how much it costs us in time and money is something about which we know astonishingly little.

On the other hand, the annual growth in our income has brought about enhanced living standards for wide sections of the population – a phenomenon which even the upsurge of promoterism in the Germany of the 1870s failed to engender. *Galbraith* even speaks of the affluent society of our times. However critical our stance on his partly exaggerated and partly one-sided theses may be, there is much (albeit not everything) to indicate that we are standing on the threshold of an epoch of wide-ranging prosperity and wealth.

Completely new communal requirements (often caused by private consumption or running parallel to it) come into being whilst old ones lose much of their significance even if the erosion is a gradual process. The impact of this is a substantial alteration in the structure of governmental spending on consumption, investment and transfer payments. A thorough examination of the coverage and distribution of the cost of these public goods is at present in progress.

It is easy to see that these evolutionary changes in economic and social reality gave a strong impetus to the promotion of a branch of science whose theoretical and empirical content has centred, since its emergence as an economic discipline, on the functions of government. The new discipline presents a mirror of public functions, measures and institutions, inasmuch as they possess any economic and political significance. The influences in question have also impinged upon the three basic areas of modern financial management. These comprise normative public finance, which describes the theory of the subject; and positive public finance which sets out to recognize, to describe and to explain what this branch of science really entails, why it has become what it is rather than something else, what it was in the past and what has revived it in the present and what appearance it will probably assume in the future. The third area, public finance considered as the art of political economy, poses the question as to the means and ways with whose help reality can best be fashioned so as to derive the optimum or maximum from the situation.

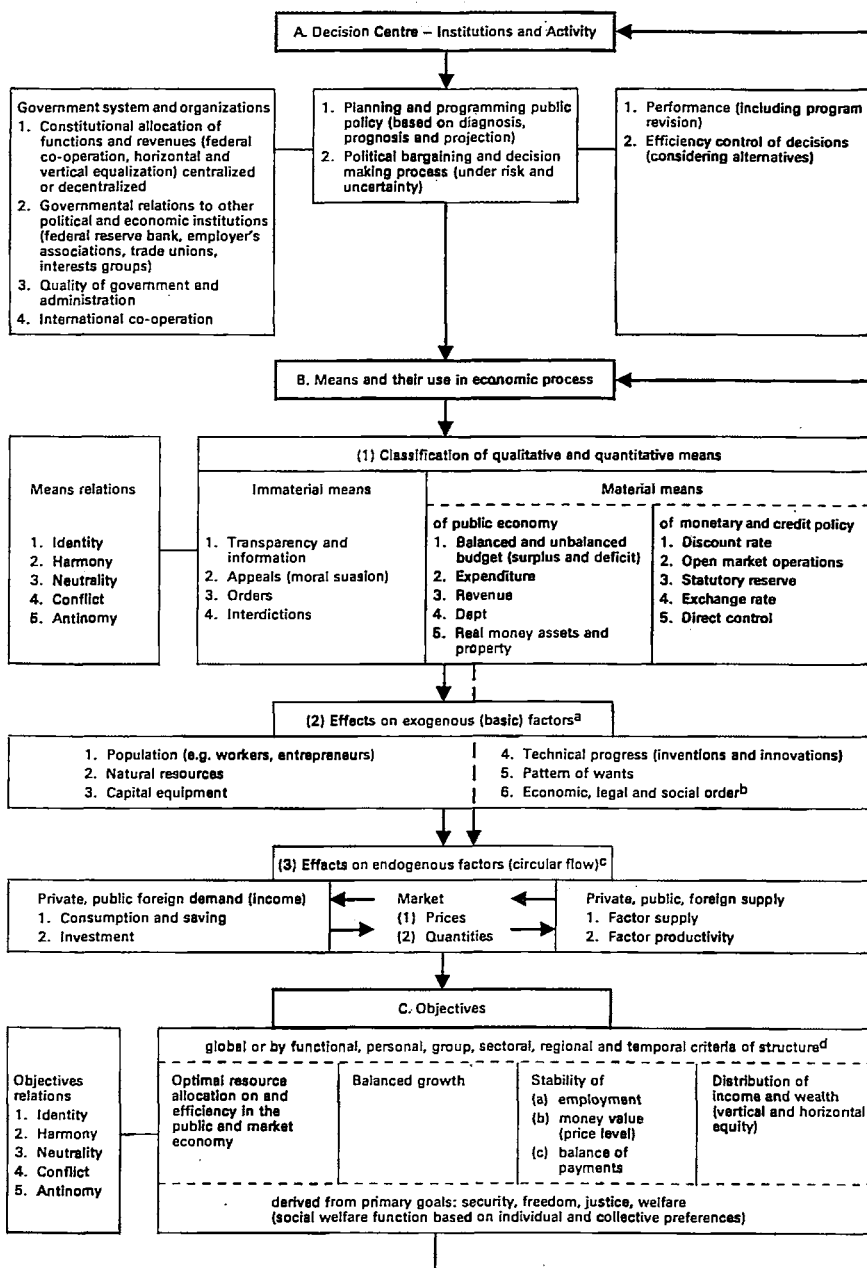
Historic Changes in Public Finance

Similar to human life, a vital academic discipline also experiences ups and downs during its existence characterized by periods of rapid growth and reform followed by times of consolidation, conservatism and even dogmatism. Sometimes, new fashionable theories put in a brief appearance and then vanish. Let us now apply all this to public finance and consider in what way the basic features of the most recent developments have emerged in this specialized branch of economics and what shape the order of priorities in goals and methods has now assumed after its numerous oscillations.

By the end of the end of the 19th century, the dynamic influence exercised by the famous triumvirate of public-finance experts in Germany (*Lorenz von Stein, Adolph Wagner and Albert Schaeffle*) was coming to an end. There came a long period of stagnation during which – as *Erwin von Beckerath* quite rightly pointed out – dull textbooks devoid of academic value such as the manuals written by *Conrad and Eberberg* spoiled this interesting economic study of current issues for a whole generation of students. Numerous publications (including above all the standard introductory textbooks) written before and even after World War II abounded with trivialities, exaggerated methodologies and pseudo-scientific descriptions of administrative and institutional problems based on «state-philosophical axioms» (*F. Neumark*). Needless to say, there were some exceptions. Public finance reached its nadir in Germany and elsewhere when it broke down completely together with other economic doctrine (apart from a few exceptions) in the face of the world economic crisis. The same held true of classical Anglo-Saxon national economy as well as of the historic school, which could not resist the temptation of continually drawing attention to the realistic conclusions of its findings. (This furnishes an apt example of what a mere collecting of facts and naive descriptions without any theoretical foundations and analytical interpretations can lead to.) A call went out for governmental abstinence, balanced budgets because of the danger of inflation and neutral financial policies. In short, the operation of the three classical principles of public finance – despite the de facto economic situation of overflowing barns and warehouses, idle factory capacity and endless queues of people unable to find work! Even to an economic tyro, that all suggests today a real challenge, since the deliberate curbing of public demand (as a parallel policy designed to balance the budget) in a situation of excess supply militates against elementary economic reason. The conventional and simple-minded view that what is good for the individual is invariably correct for the economy as a whole turned out to be completely wrong. More saving can yield disastrous consequences. Even a balanced budget need not necessarily exercise a neutral impact (*Haavelmo theorem*).

Within the context of these revolutionary changes in the intellectual and political fields, a

A System of Integrated Economic and Fiscal Policy



a) Basic policies

b) Order policy (with goals like freedom, private property, competition)

c) Process policy in short, middle, and long term

d) Comprehensive structure policy (concerning all objectives)

e) Reversal of the means-objective dichotomy. The question of how a change of the goal-variable does affect means. Institutions, and activity is becoming a very important one for modern economic and fiscal policy.

process of ascertaining new theoretical foundations and economic bases for the study of public finance has now got underway and no-one yet knows how far this will go. The goal seems, however, to consist in a complete renaissance in political economy, albeit with a different subject matter. The provisional outcome is a wide measure of fusion between economic and financial theory and a gradual absorption of financial policy into economic policy. This amalgamation naturally prompts the question as to how far this branch of the three parts of national economy – a classification which our academic institutions and many textbooks still accept today – can genuinely be described as independent.

Together with the methods employed in research and teaching, the essential issues and problems of this fascinating discipline have also altered in such a manner as to transcend the traditional frame of reference and even the name. The term «public finance» no longer embraces all the theoretical and practical aspects of the subject. For, the items for research and teaching are not only or even primarily matters of public finance. Similar to the two other disciplines, i. e. general and special economics (which have also undergone a «mutation»), the basic issues in this discipline are chiefly of a non-financial nature. The real interest attaches to the assumptions governing the public sector in general (and not simply public finance) and its active inter-relationship with the overall economy so that the spectrum of problems ranges from the activation and allocation of national resources via the distribution of income and wealth to the stability of growth. The principal theme in modern financial management consists in illuminating, by means of budgetary and marketing theory, the circulation of goods and services within the public sector and the interdependence between the latter and the country's whole economy so as to achieve fruitful and rational economic policies. One of its main tasks is the study of the overall national economy and the preparation of economic decisions.

Let me add another point about economic independence. Neither the criterion of public and private property adduced to separate the market economy from the public economy nor the mutual characteristic of the personal benefits derived from all goods suffice by themselves to provide a definitive answer to the as yet open question of the real position of modern public finance doctrine. However, one thing is already clear:

(1) The oversimplified classification of goods into purely public and purely private goods has substantially blocked our overview of the relevant implications.

(2) The features common to both spheres simply cannot be overlooked. The public sector is governed by economic laws and influences just like any other sphere where people wish to meet their unrestricted needs by means of their scarce resources. The State should therefore act in accordance with the economic principle of either minimizing expenses or earning maximum benefits from scarce means. This cardinal principle is completely or partly concealed or even falsified if one regards the meeting of the (superficial) financial requirements as forming a contrast to the maximization of private profits – a view widely disseminated in economic literature. The fact that public demand (when spelled out as a specific task or goal) cannot always be expressed precisely in quantitative and qualitative terms and that we therefore usually «only» attempt to minimize the costs does not fundamentally alter any aspect of the applicability of this economic principle. One point which seems to be completely misleading is the customary objection to this economic behaviour that the decision on the scale, type and distribution of public services springs from political considerations and that it emerges with the help of a bureaucratic apparatus. This would mean in the long run that a collective may squander scarce resources, even though the State's share of the G. N. P. already amounts to nearly 50%. Another point. Why ought not education, its efficiency and the distribution of its benefits and burdens also be observed and illuminated in the light of economic criteria? Why ought not defence expenditure and its teleological interpretation (based on supposed purpose or intention) be viewed in economic terms and subjected to the criterion of economic principles such as a cost-benefit analysis? Why should there not be a systematic examination of what a new law costs and what

advantages or how much social justice it confers? Why do the authorities refrain from comparing the average or marginal fiscal yield from the salt tax with the concomitant administrative costs?

(3) Despite the fact that collective and therefore also political decision-making – linked to the budgetary mechanism – differs from the individual regulative principle governing the market and aggravates the attainment of complete amalgamation within a comprehensive theory for the whole economy, it is nevertheless evident that the long dominating concept of a separate discipline of public finance as a product of financial management based largely on administration and legal relationships has meanwhile become completely antiquated in the academic world, even though it retains a great deal of its vitality in practice.

In the light of this sketch of current trends and aspirations, there emerge more clearly than ever the persistent and one-sided features and deficiencies of all financial aspects of the earlier epochs: the dogmatic characteristics of a mercantilistic and cameralistic public finance, the treatment of the public sector as an alien element in the market economy and its logical links in the circulation of goods and services with the then uninteresting problem of consumption as described by some of the classical writers such as *Jean Baptiste Say*. To this should be added the almost modern interpretation of state activities as the production of intangible assets (*Friedrich List* and *Adolph Wagner*), the emphasis placed on the public advantages of the economic system in contrast to the profit motive in a free market economy (*Albert Schaeffle* and his successors) and finally the splitting of the national economy into its individual and collective benefits (under a subjective value theory) in the writings of *Emil Sax* – described by *E. von Beckerath* as «brilliantly one-sided».

Although these may be one-sided approaches when measured or projected against the knowledge and practical experience gained in our age, they also contain elements of our active knowledge and our academic experience. It would be highly unfair if we attempted to gauge these great ideas and original systems of past generations solely in terms of the assistance which they furnish for us today. Yet if history is to help us in our search for truth and understanding in shaping our rapidly changing world, then it must not confine itself as a record of past dogmas to a more or less *formal* ordering of theories (with and without historic facts). It must also maintain vital links with the investigations into the academic and practical problems of our age. By dint of a comparison with the questions, methods and results of the research carried out in other epochs, we ought to be able to map out the limits of our own horizon and the finite character of our understanding.

What we still lack today is a *modern* account of public finance and a comprehensive history of its theory. The Historic School proved unequal to the task in the end, even though some of the chapters in the classical introductions abound with fine ideas and descriptions.

The Current Status of Public Economy

I. To begin with, there is the traditional field of financial management concerned with meeting public demand and culminating in the principle of equitable taxation. Until quite recently (up to *Wilhelm Gerloff*), the latter was regarded as virtually its sole task. Public finance is viewed above all from the standpoint of its *institutional framework* and the technical aspects of *financial operations*. The outcome of these studies still determines the picture which many of us conjure up of this economic discipline, both in practice and in theory. This consists of mostly speculative ideas on the subject i. e. the State together with scientifically unfounded views on political aims and formalistic rules on drawing up, implementing and controlling the budget for an administration which, as a rule, proves to be indiscriminating in economic matters and without any proper economic training. It seems almost ironic that the *Stability Law* (and with it the departure from the myth of a sacrosanct

balancing of the budget in the interest of effectively influencing the volume of economic activity) has finally incorporated the results of basic research after a delay of some 40 years.

Contemporary scholars have pursued three different lines of inquiry in the domain of «classical» public finance:

(1) The usual speculative theories on the State are being replaced by theoretical and empirical investigations of the decision-making process, including all those forces which in practice impinge in our pluralistic society – both within and without Government, Parliament and Administration – upon political decisions and the implementation of the requisite measures. When reduced to a simple denominator, they provide the basis for a political theory of economic decisions and attempts to draw up an economic theory of political processes. Analyses of vote – maximization or of the bureaucracy set out to develop an autonomous allocation mechanism. Clearly, the universal sociological systems outlined by classical German writers on finance theories and thus the whole field of sociology taught in the nineteenth century are now out of date and inappropriate for our different environment of today. As far as I can see, neither the financial sociologists nor the financial psychologists nor the political scientists have been able to develop a well-rounded approach, for example by further developing the theories of *Marx* and *Pareto* or *Lorenz von Stein*. Much of the accepted doctrine is now in a state of flux or marked by uncertainty. In more recent times, a naive kind of empiricism has met with a cordial welcome – an understandable reaction to many Utopian aspects of the past. Nevertheless, there still sometimes persist grotesque views (particularly in public) about the actual influence wielded by individual groups on political decisions.

(2) One apparently major contribution by economic and financial theorists to these political and institutional problems ensues from another sphere, i. e. from the search for an answer to the question as to how the «State» should act and decide, and actually does act in practice. This represents an investigation into the optimal range of the State's activities, linked to the politically most appropriate electoral machinery. The aim of such a theory of government expenditure consists in determining a maximum of economic benefits in theory and in attaining them in practice. Some of the major contributions of the theoretical foundations have come from welfare theory (K. J. *Arrow*, R. A. *Dahl*, C. E. *Lindblom*, P. A. *Samuelson*, R. A. *Musgrave* and A. *Downs*), despite the fact that much of this has merely involved fruitful beginnings followed by limited practical results. Economic writers have also developed an electoral mechanism on the basis of individual preferences and, to a certain extent, this will have its analogy in the market mechanism. Financial theory provides a number of electoral systems which take into account strategic considerations (such as the simple majority voting system with protection for minorities). This can fall back on classical ideas (*Wicksell*, *Lindahl*).

The outdated budgetary system ought to be completely reorganized. It is to be hoped that the financial and political pressure towards rationalizing the purely technical operations will exercise salutary pressure on an accounting system in which budgeting, property and debts largely co-exist as unlinked processes. The Americans have attempted to unite the three major budgets in practice i. e. for cash flow, administration and the economy within one *uniform* budget and to define its contents and limits. *Musgrave's* pioneer work on multiple budgets combines the three fundamental aims of modern financial policy. On the other hand, the programme budget based on a cost-benefit analysis or the pragmatic zero-base budget rest solely on the long neglected efficiency of individual governmental projects. The need to develop new procedures (which will also cover «classical» public goods) and also to find a practicable synthesis remains one of the chief tasks of financial theory at the present time. Carrot-and-stick techniques should be used to promote a uniting of bureaucrats' self-interest with the common weal.

(3) Finally, attention should be drawn to the decentralized distribution of functions and receipts, which has formed one of the subjects for research recently. How should the

responsibilities for financial policy be ideally distributed in a federal State? What correction of regional economic spread is necessary by means of a fiscal adjustment between authorities at the same and at different levels? Writers on this subject quote not only equitable treatment (*Buchanan*), but also the other fiscal goals as the criterion for adequate policies on taxation, expenditure and indebtedness. These authors see as the centrepiece of any analysis of financial federalism the principle of an independent interlinked system between the users, payers, decision-makers and suppliers of public services, whilst assigning due importance to the external influences and the economies of scale designed to enhance profitability. Similar problems arise in the (equally new research) area of international finance, although in this case specific problems ensue from national sovereignty over finance, currency and trade.

There is no need in this context to detail those areas in which the majority of modern writers find governmental activity to be justifiable. On the contrary, it may perhaps surprise readers to hear that *Adam Smith's* catalogue of economically and socially «justifiable» state activities was not much smaller than it is today. The latter may be briefly delineated as follows. In principle, the State should only play an alternative role in the economic sector where the market mechanism has been substantially curtailed or where it has broken down completely.

Shortcomings on the market do not in themselves justify any direct governmental interference as long as one has insufficient knowledge about the «welfare losses» of official measures. The classification of state activity – i. e. where it partakes of a preventive and corrective nature, produces goods and services itself or influences their distribution, arranges to provide the necessary funds and thus buys a share in the private sector – is primarily a question of economic efficiency. Viewed in this light, the following are deemed to be public functions:

- (1) Safeguarding efficient competition.
- (2) Redistributing income and wealth for economic and social reasons via taxes and subsidies among private households and commercial enterprises provided that they do not enjoy sufficient assistance of their own. Also, an improvement in primary distribution through more balanced starting conditions.
- (3) Stabilizing the short and long-term cycles of economic activity and growth coupled with balanced foreign trade and payments.
- (4) Corrective adjustment of the divergence in the production and distribution results from the optimum due to technical factors (incomplete divisibility, necessity of integration, natural monopolies). These largely involve «public utilities» in the sense of the term as used by Adam Smith i. e. of the greatest benefit for a large community, yet of such a nature that the profit never covers expenditure, either for the individual or for a small group.
- (5) Elimination of the divergence between external economies and diseconomies.
- (6) Promotion of investments characterized by a wide measure of risk up to the point of time when production can be commenced by private entrepreneurs under competitive conditions (basic research, major projects for producing energy).
- (7) Guarantees on external and internal security including our democratic social system. In this case, the direct and indirect use of the multifarious safeguards against the hazards to life, limb and property cannot be directly assigned to the individual, since all «consumers» have these services available to them in equal measure. Nobody can be excluded or forced to announce the urgency of his demand.

It only remains to add a few words on production and services in the public sector, which have hitherto remained enveloped in the mists of ideological exaggeration and romantic distortion. If we regard the problems in the cold light of economic theory, we find the following situation:

- (a) In empirical terms, state expenditure does not constitute an indicator appropriate for expressing the volume of communal production of public goods. (For instance, goods and

services for defensive purposes and space research in Germany and the USA are produced almost exclusively by private enterprise).

(b) As O. Eckstein has pointed out, «the study of the economics of public expenditures is still in its infancy.»

(c) The efficiency of genuine state activity is still largely unresearched in regard to individual businesses, branch establishments and the economy as a whole.

(d) Few studies have been carried out on effective means for the control and reduction of superfluous institutions for outmoded governmental functions because of the absence of acceptable criteria. In this respect, we have hardly progressed beyond the humorous and naive rules devised by *Parkinson*. Let me enunciate these in my own words:

(a) Administrations continue to grow even when their functions have virtually dwindled to nought; and

(b) The civil servants' craving for professional recognition and social prestige invariably bring about an expansion of costs in their particular sector.

The goal of an optimal allocation of productive facilities may well clash with that of an optimal distribution of income, since all growth in production exercises a distributive impact – and this also alters the assumed distribution of income. The latest investigations in this marginal field have attempted to do justice to both aspects of public assets or else to develop specific instruments such as the negative income tax.

The theory of a budgetary allocation of income and wealth has both curtailed and substantially supplemented the findings of the rational, albeit unilateral doctrine of redistribution via taxation. As far as possible, analyses now incorporate the distributive impact of government expenditure. This covers the sphere which in *Wagner's* era was associated with the socio-political aspects of the national economy. If we express this in more modern and comprehensive terminology, it deals with the effect of governmental activities on the distribution of income and wealth in a market economy characterized by full employment. This redistribution may be measured in terms of personnel as well as sociological, functional, sectoral, national and regional activities.

II. Even in the most recent branch of *fiscal theory* and *fiscal policy*, which – leaving aside the precursors among German economic writers – was founded in connection with *Keynes' General Theory*, researchers have made such rapid progress as to transcend the limits of previous theories and the reputations of established experts. Broadly speaking, I am referring to that area of economics which concerns itself with the effects of financial measures on economic processes. In conjunction with the money theory, it directs its attention to the *short-term* stabilization of the market economy combined with the prevention of deflation and inflation as well as to the achievement of full employment together with a balance-of-payments equilibrium. Successful use is made in this field of the instruments of modern micro- and macroeconomic theory: sequential and circulatory analysis, earnings multipliers and accelerators, time-lags etc – all of them now forming the stock-in-trade of this branch of economics. Moreover, simulation models help in corroborating forecasts. At the beginning of the 1970s, stagflation began to pose new problems for stability policy. As unemployment is now sometimes also accompanied by inflation, *Keynes' battery* of instruments for attaining simultaneously the goal of high employment and price stability fails to produce the desired results. This completely new situation has given a fresh thrust to monetary, neoclassic and post-*Keynesian* basic research, as may be seen from the controversy about the *Phillip's curve*. The recommendations on appropriate economic measures have altered accordingly.

The new findings about the cyclical links between public economy and market economy have exercised both a direct and an indirect influence – via academic advisers and committees – on the principal economic decisions adopted by nearly all European industrialized countries in our epoch. In this context, the dominating factor has been the more demand-oriented theories and in particular a differentiated analysis of specific expenditure multipliers

or of appropriate criteria for the cyclical efficiency of the budget. In the medium and longer term, the complementary and neutral and substitutive relations between market economy and public economy are examined in order to gain greater insight into the interplay between the two from the standpoint of the supply of goods. More recently, the impact produced by state expenditure on aggregate economic efficiency has been discussed. The State is still just as poorly integrated into growth theory as it is into the national accounts which, illogically, endeavour to combine commercial considerations with the cameralistic principle.

Naturally, there have also been exaggerations and excesses in this «revolution». Genuine doubts and reservations have appeared when:

(a) the modern theoretical instruments are applied with a vigour which hardly makes any allowance for certain undeniable fundamental differences between a market economy and a public economy;

(b) the assumptions or hypotheses are not sufficiently backed by historic facts and institutional experience; and when

(c) people forget that the results bear the stamp of economic one-sidedness.

As I have pointed out, however, these are exaggerations and they are fairly rare. It is already possible today to say what will last. As *Karl Marx* once put it, much of that will land on the rubbish heap of history before it even reaches the textbooks, simply because the economic conditions of the present time have basically changed in comparison with the Thirties, Forties and even the Fifties. For example, under-employment à la *Keynes* has little in common with technological unemployment and positive growth. Since 1945, there have not been any trade cycles of the conventional kind. A market economy in which technical progress decisively determines material wealth and makes sure that the share of supplies accounted for by completely new goods grows incredibly fast is confronted by new adjustment problems just as much as national financial policy. The main engine driving the market economy is the competition furnished by new goods and methods and not the old sleepy-headed type of competition (*Lutz*). It is they which breach the traditional forms of marketing. All this calls for totally different forms of «adaptation grants» by the community and an entirely different economic attitude by the State in the private sector. By the same token, we cannot simply eliminate a modern demand-pull inflation caused by sectional self-interests by changing public revenue and expenditure.

In point of fact, fiscal theory has changed considerably in the last few years. More recently, a subject for research which is closely linked with economic growth has achieved considerable prominence. The financial researchers have started to look into the theoretical and empirical relations existing between public economy and the development of productive facilities i. e. the economic foundations of a free market economy. This marks a veritable race to determine the priority for basic ideas and findings. This takes place on two planes. Firstly, in the extension of the narrow growth theories à la *Domar* and *Harrod*, which also embrace governmental activities; and secondly in the continuation of the type of development theory drafted by *Marx*, *Wagner*, *Schumpeter* and *Rostow*. The sterility of the narrow growth theories – the neoclassical and the post-Keynesian – with their incipient methodical weaknesses has not yet been overcome. One way out of this dilemma would seem to consist in the inclusion of the distributive pattern for incomes such as *Bombach* and others have proposed. The linking of long-term and short-term views has led to the medium-term analysis now to be found above all in financial planning (aiming at budgets with a neutral effect on the business cycle).

III. Whereas the theory of public expenditure has hitherto been assigned to the field of politics due to *Adolph Wagner's* influence and often sadly neglected, the chief interest today focuses on the substance of governmental decisions. They are no longer unilaterally regarded as an alien exogenous disturbance to economic considerations or the plans of private households and commercial enterprises. Moreover, their political nature does not place them either outside or above the economic laws. The important thing in numerous studies

has been to assess and measure governmental activities as well as the multifarious effects on the major aims together with theoretical interpretations of the growth in public expenditure.

The search instituted on an empirical and statistical basis for the causes and driving forces behind the expansion of *de facto* public expenditure during the last hundred years together with the academic discussion of how best to measure governmental activities have led to views and findings which possess considerable importance for the relevant problems, but which are still unsatisfactory.

As regards the circulatory flow in the national economy, the main feature of the analysis carried out there (pursuant to cost-benefit methods) has been the evaluation of public goods and services. There is still no bridge linking these two spheres. Although the income theory effected a decisive contribution towards combining public-economy earnings and market-economy earnings in the national accounts, there nevertheless persist a number of weaknesses and hazards in the analysis of the theory of the circulatory flow:

(1) Government consumption is gauged by *public* expenditure.

(2) Private and public income and transaction flows are regarded as homogeneous overall totals notwithstanding the fact that the market assesses everything on a continuous basis but the politicians for at most one year. In their current shape, political controls are no substitute for market risks. Within the public economy, nobody really bothers in an effective manner about rationality, efficiency, justice, collective decisions and acts. But in this field, virtually a «second» revolution has taken place. An attempt is now being made to transfer the principles of economic rationality, motivation and control to the public sector. The groundwork has also been laid for a theory of «state failures» from which a number of possible reforms may be derived. These range from a renaissance of the equivalence theory in all its variants (interdependent linked systems, fiscal equivalence, the fees principle, subjective rather than objective subsidization, return of public property to private ownership and the transfer of tasks to private groups) via an improvement in the completely antiquated accounting system (NKA, programme budgeting, the integration of capital accounts with budget accounts and redistributive budgeting) down to incentives and penalties for faulty bureaucratic behaviour (a flexible wages system, liability of civil servants to dismissal like other employees, making wages partly dependent on costs, the tying of budgetary appropriations to economic indicators and compulsion to adopt alternative philosophies as a result of *ad hoc* budgetary techniques). More recently, the importance has been recognized of illuminating the whole field of legislation on taxes as well as their collection, administration and disbursement in the light of economic criteria.

As for the impact of expenditure, a distinction is drawn analogous to receipts in respect of the chief aims with the principal emphasis at the present time being laid upon the actual incidence of the disbursements (i. e. who really benefits from public goods?) and upon the growth impact. The theoretical bases for subsidies and transfer payments are still in their initial phase. Moreover, they have been developed from the standpoint of chronological redistribution rather than efficiency. Much is now in a state of flux, too, in the theories propounded about public revenue. Fees and taxes in particular are carefully examined and researched from various angles by means of fresh procedures. Even the theoretical basis for equitable taxation, (i. e. pursuant to the principle of productive capacity and benefit in its present form) is questioned whilst the distortion produced by taxes in the market-economy decisions of consumers and producers (the «excess burdens») – a cornerstone of the theory of indirect and direct taxes – also forms the subject of critical assessment. The welfare theories designed to justify progressive scales in taxation have also elicited modest acceptance only, and they are now being curtailed. An attempt is also being made to ascertain in comprehensive manner the apportioning of the benefits and burdens of State activities in order to arrive at norms of justice, whatever their definition, with due attention being paid to the relationship between «giving, taking and decision-making».

The micro- and macro-economic theory governing a new outlook on the impact of

taxation covers the whole scale of government functions: it incorporates psychological and sociological incentives and disincentives, and also turns its attention to clashes in objectives resulting from taxation. The greatest efforts have been undertaken to research the incidence of taxes, even though the answer to the all-important question of who finally has to bear the burden of income and corporation tax remains enveloped in controversy. At all events, many experts have voiced their doubts about the orthodox view that such burdens cannot simply be passed on. If *Föhl's* or *Musgrave – Krzyzaniak's* thesis about completely passing forward or back these burdens were to prove correct, then that would have extraordinary consequences for the existing tax systems in the Western world.

As a result of their empirical findings, the most recent analyses have substantially retrenched both the optimistic and the pessimistic hypotheses about passing on the tax burdens and set out limits within which actual redistribution takes place. The index-linking of tax burdens and their ties with economic growth have also introduced a new element into theoretical considerations. As regards the problems of special taxes, the original idea of a tax on expenditure merits further consideration – though with certain reservations – as does the theory behind value-added taxes and the incidence of excise duties. An attempt has also been made to propound an optimal and rational tax system which will fulfil the main aims with maximum efficiency, avoid a clash in goals as much as possible, produce a good fiscal yield and satisfy Smith's principle of cheapness of collection.

The theory of the national debt has also been in a state of flux during the last generation. Whereas the magnitude of public indebtedness used to be a subject for violent controversy due to the influence of Keynesian ideas, two problems have come to the fore during the past decade:

(a) the classical question of who should bear the «burden» of public debts, the present or the future generation? In this respect, the analysts are widening the scope of this field by incorporating not only the costs, but also the benefits of public goods. The chronological incidence of the national debt has again become a matter of interest.

(b) The question arises at the dividing line between monetary and credit theory as to the effects produced by a change in the national debt on the most important goals of the Government's financial policy – including the problem of how to achieve optimum results in regard to financial costs as the ultimate goal of economic efficiency (debt management).

Finally, a whole new academic discipline has arisen in recent times, dedicated to the study of international reciprocal relations ranging from the financial policy of nationally independent and economically integrating States to a fully fledged customs and economic union. Apart from this problem of harmonizing income, expenditure and debts which, as already explained, is closely connected with the decentralized distribution of tasks in a federal State, increasing importance now attaches to the tax and expenditure policy of international institutions (such as UNO).

Future Prospects

As I see things, Profical Economy has a special role to play in bridging the differences between individual and collective decisions so that the tension between market and public economy can be relaxed without jeopardizing private enterprise and personal freedom. In this way, economics may help to reduce and eliminate the ideological tension inherent in those worn-out watchwords of yester-year – «capitalism» and «socialism». Economic studies derive their legitimation from their main objective of obtaining a complete command of the market and budget mechanism as theoretical and practical instruments for regulating modern Western industrialized societies and also of applying these instruments in a rational manner. These are two forms of organization which determine the rational incorporation and efficient use of a nation's resources and regulate the distribution of its goods so as to

safeguard economic and social equilibrium within a tolerable margin of oscillation together with steady economic growth. Once that we have recognized what may be expected of these two regulative concepts in the overall circulatory flow of goods and services and what tasks they are capable of fulfilling, then the scarce resources of the nation can be satisfactorily exploited and equitably distributed.

As we have seen, the traditional and modern branches of public-economy theory have been thoroughly researched by dint of new methods – not all of them economic in nature. A great deal is, however, now in a state of flux. In recent years, the chief issue for researchers into fiscal policy has been to study the short-term and long-term impact of state revenue, expenditure and credit on the size, composition and growth of the G. N. P. and to consider how to employ fiscal and monetary instruments in an appropriate manner for realizing practical economic policy. Relatively little attention has been paid to the opposite question. From the standpoint of growth, we shall in future have to abandon this one-way street and overcome the «established» dichotomy of means and goals so that the following questions can attract equal interest in theoretical and empirical research: how does a sustained increase in affluence or a noticeable depreciation of currency or redistribution of income and wealth influence the pattern of public economy and specifically the volume and structure of income and expenditure, the pattern of assets and debts and finally the process of political decision-making – i. e. those forces, motives and criteria which govern the formation of financial intent up to the adoption of the final decision?

Among the feedback effects, mention may be made of the growth-induced changes in the national budget or in the capital structure rather than those changes which become indispensable because of growth.

In a welfare society with a relatively wide spread of material goods, the functions and structure of public economy and market economy will undoubtedly alter to a considerable degree the antiquated practical and regional classification of administration and the whole infrastructure. This process is being decisively promoted by the improved and extended cost-benefit-analysis which serves as the basis for an operational programme budget. In this field, the interest shown by modern economic researchers in the theory of decision-making has proved to be very fruitful. I am thinking in particular of the need for an efficient infrastructure – the so important (yet hardly researched) link between market and public economy and the residuum of every economic development.

Even the hierarchy of overriding values or normative guiding models as the mirror of cultural traditions, civilization and ideology starts to lose its rigidity when mankind's material foundations improve substantially and when the individual is enabled to participate in intellectual and cultural amenities whether actively, receptively or passively.

And there is another thing. A scientific epoch in which the speculative approach assumes less and less importance as the rational approach gains the upper hand in the form of model philosophies requires the backing or correlation of genuine historic-empirical experience in the understanding and shaping of a rapidly changing world; otherwise the outcome may well be a one-sided outlook on the relevant issues and findings. The majority of modern academic analysts and economists know of the unity between theory (mathematics) and reality (history) and they cherish a feeling and sense of perspective for history and for Max Weber's most valuable maxim i. e. that «the dignity of norms is only discovered when they come to be fulfilled in real life».

Chapter II Distribution

Section I Market Income

The Value and Remuneration of Work

Johann Heinrich von Thünen

1850

[. . .] Of what avail are the pious wishes for higher remuneration and wider instruction for the workers unless proof be furnished of their compatibility with the properties and energies peculiar to human nature?

Consider the workshops forced to close their doors when wages rise! Is it not so that greater reward will bring to an end the cultivation of wide expanses of fertile soil? And will not the lot of the work-people thereby grow more sombre than at the present time?

Only a more profound immersion into that science which explains the laws of conduct emanating from humane nature can provide enlightenment about these matters. If we are desirous of shedding light on this subject so closely bound up with the fate of humanity, let us turn our minds to systematic research, however uninviting and thorny the path may be.

[. . .] Although *A. Smith* illuminated so many themes of everyday life and thus spared his successors the time and effort needed to pursue their own researches, these writers are nevertheless obliged – even where possessed of lesser talent – to fill in the gaps which he left in our knowledge and to broach fresh problems for our behoof and benefit.

When we scan and consider the uneven spread of blessings on this earth and behold the pittance paid to the workers for their strenuous daily labours of which the community has such great need, all of us able to use our brains must surely feel compelled to subject the impressions and prejudices imbibed since infancy to a scrutiny and to seek after the reasons for this situation. The questions we must ask ourselves are:

1. Why does the estate owner derive a rent from his land without effort or toil and why cannot wages rise so much that this rent be apportioned among the workmen, who seem to have a much fairer claim to it?

2. Does the modest recompense for manual toil derive from the nature of industry and agriculture and thus remain subject to the will of Providence or has the present condition arisen through force and oppression which the working class cannot evade?

Among the diverse standpoints which, we hope, will illumine this topic for us, the

investigation most likely to achieve the desired goal is the answer to the question; «what are the consequences of a rise in wages?»

In reality, the circumstances of commercial activities are so complex and interlocked that our scrutiny engenders a certain confusion before the latest consequences of a rise in wages have been perceived. When answering this inquiry, we must therefore first turn our attention to the «solitary State», where conditions are as simple as they possibly could be.

At the dividing-line on the cultivated expanses of the solitary State where the soil yields no rent and the profit consists solely of the interest paid on capital invested in the buildings and so forth, an increase in wages is bound to render the ground-rent negative i. e. to reduce it to below nil.

Yet where cultivation of the soil entails continuous losses for the owner, he will cease to erect new buildings and indeed quit his estate as soon as the old buildings threaten to collapse. The soil will then lie fallow, and the farmers will retreat to a distance from the town at which the previous ground-rent proves able to cover the amount of the augmented wages.

The labourers of the now depleted district must look for work and subsistence in the surroundings of the town where higher wages can be paid at the expense of the groundrent. Yet so many people are already employed on the farms in these areas that the product of the last labourer to be engaged only just covers the wage which he receives. Where more workmen are to be engaged, methods of cultivation must be adopted which are less profitable and which have not proved worthwhile for the wages so far paid. Hence, the additional labourers can only find jobs if they are prepared to work for lower wages than hitherto. Indigence forces them to accept these smaller wages and the competition thus created then forces down the wages of those labourers already in employment for some time.

Hence, the attempt to raise wages brings about the opposite and renders the position of the work-people even worse.

In consequence, we reach the conclusion that the low level of wages derives from the nature of the occupation and that an increase is impossible.

[. . .] If we subtract from an entrepreneur's profit

1. His interest on the invested capital
2. The insurance premium against shipwreck, fire, damage caused by a hailstorm etc. and
3. The wages of a clerk and administrator/supervisor, there normally remains a surplus for the entrepreneur and that constitutes his profit.

On what does this profit rest and why is it not nullified by competition among the entrepreneurs themselves seeing that the use of the capital is remunerated and offset by the deducted interest, the hazards peculiar to the business by the deducted insurance contributions and the strains of management by the salary paid to the administrator? . . .

No insurance company can possibly cover each and every hazard to which we are exposed upon taking up a certain occupation: some of the risk must always be borne by entrepreneurs themselves. A reduction in the price of products, manufactures and articles may in itself cost the tenant-farmer or manufacturer or merchant his whole fortune – and there is no insurance cover against that danger.

The reader may rejoin that a new entrepreneur, basing his estimates on the previous average prices of products or articles, may well lose money when prices fall below the previous average price, but he will gain just as often – and perhaps even more often – when they rise. The risk is compensated by the prospect of a profit, and no need arises for an indemnity.

An insurance company may proceed in pursuance of this principle, but not a private individual. The very reason underlying the need for entrepreneurial profit lies in the difference between a business enterprise in which each shareholder only risks part of his assets and an entrepreneur who stands to lose every penny which he possesses.

Anyone who has 10,000 talers may readily wager one taler in a bet without jeopardizing his happiness, and the pleasure derived from a profit requites the discomfort felt upon a loss.

But if that same person were to wager his entire fortune of 10,000 talers in a single venture, the doubling of his assets in the event of the best possible outcome would not add as much to his happiness as he would forfeit in enjoyment and contentment in the worst contingency of losing the whole of his money.

Anyone with sufficient funds to defray the cost attendant upon the acquisition of the knowledge and training needed for the public service has the option of either joining the latter or – if he is endowed with equal aptitude for both vocations – becoming an entrepreneur. Where he chooses the former, his substance is secure for his entire life once that he has received his appointment. If he decides to become an entrepreneur, an unfavourable turn of events may rapidly deprive him of his personal fortune, leaving him with no other choice but to become a paid workman.

In the light of such unequal future prospects, what could induce anyone to become an entrepreneur apart from the likelihood that his profit will be much greater than the loss?

Inasmuch as the loss of part or all of one's fortune inflicts a more grievous hurt on one's happiness and contentment than an increment to one's assets of the same magnitude would add to one's bliss, so the probability of attaining a profit in a business undertaking must be greater than the probability of a loss.

[. . .] The aspiration of the producers consists in increasing the number of workmen to the point where no more advantage will accrue to them from a further increase, i. e. until the wages for the work match the value of the work, because, this is inherently in the nature of the situation and consonant with the entrepreneur's interests.

However, the wage received by the last workman to be engaged must act as a norm for all workers with the same degree of skill and proficiency, since one cannot pay different wages for the same services.

But if in reality the wage corresponds to the value of the work and the population nevertheless remains in a distressed and indigent condition, how is a remedy possible in that case?

In his philosophy of political economy, *Proudhon* expresses disapproval of the fact that a notary receives as much for a document drafted within one hour as a day labourer in twelve hours of hard work. The same author also deprecates the injustice of giving a higher rate of remuneration to a factory-foreman than to a porter.

But let us ask the factory owner what induces him to pay more to the foreman. It is not favour or philanthropy or friendship. Indeed, he would get rid of him without delay if he could do without him and if the benefits of his work did not at least correspond to his wages. Here, again, the value of the performance serves as the criterion for remuneration. It would be a chimera not to pay wages according to the value of the work but to use the working-time as a yardstick for wage payments.

If, however, the workers receive the value of their labour in the wages, it follows that the distressed condition of the work-people does not stem from greed and lust for profit among the owners of land and factories since the latter cannot pay more for the work than it is worth – and there can be no talk of providing alms! In other words, the source of distress among the working class must lie elsewhere and the search for it must go down much deeper.

The rejoinder to this might read as follows. «If the last workers to be employed do not produce more than they receive by way of wages, those engaged at an earlier stage furnish the entrepreneurs with a very substantial surplus, thus according to them the funds with which to pay higher wages. Hence, the only thing needed to improve the lot of the workers is the good will of the producers».

Such an objection would, however, contain a blend of moral duty and commercial necessity and a confusion between the two.

If the resources of a country are to be used in the most rational way, no work shall be undertaken unless it covers the costs. Otherwise, the activities intended to create national

wealth would diminish and erode it. The resulting diminution of national capital would only make the population more poverty-stricken than before.

The moral duty of the wealthy to alleviate the distress of the poor must not be translated into practice in this way: another path must be chosen.

Furthermore, a manufacturer who undertook work which did not recoup the costs would be sacrificing his fortune in vain if all the others did not do likewise. But even a joint action of all national factory-owners would be insufficient for this purpose: exporters and import-competing industries would go bankrupt and their workers would lose their jobs.

In order to make our subject clearer, let us now consider the essential effects of a rise and fall in remuneration.

Let us assume that a rise in wages takes place without any cut in the number of labourers. The last labourers to be engaged will then cost the land-owner and manufacturer more than they yield by way of profit. Pursuant to their interests, the land-owner and manufacturer will then dismiss labourers – and that is no injustice but consonant with their profession – and they will continue this procedure until the product of the last remaining workman equates to the value of the increased wage. In this way, a large number of labourers will lose their livelihood and, in order not to starve, they will have to decide once more to work for their former wages. In other words, a rise in their wages is not possible in these circumstances.

If on the other hand the population of the working classes grows whilst the land under cultivation and the invested capital remain constant, the newly arriving workmen will not find any jobs at the wages hitherto paid. In effect, since this wage equates to the whole product of the last workman to be engaged and every new labourer will supply an ever decreasing product, the absorption of the new labourers at the old wages is certain to bring a loss in its train for the employer. Only if these labourers put up with lower wages will the entrepreneurs be able to engage them and undertake new work whose value corresponds to the lower wage.

But if the labourers now grow in number despite their falling wages, the latter must necessarily continue to go down because the work available for them becomes less and less productive.

And if the growth in population implies that the work must be extended to more and more unproductive undertakings and worse and worse soil, where will the fall in wages come to a halt?

That limit is not reached until the work becomes so unproductive that the product of labour equates to the cost of the requisite means of subsistence. In truth, man cannot work for a smaller wage than that required for his livelihood.

Be that as it may, individuals are not endowed with the same strength, health and proficiency – as we assumed them to be in our «solitary state» – but very unequal in all these respects. The question then arises for which of these workers the wage should fall to the subsistence level. That depends in turn on the number of available workers. Where a surplus of them exists, only the healthiest and strongest of them will find employment and the others will remain out of work. But as man's strength does not remain constant in the various ages of life but diminishes with advancing years, it may come to pass that even the most capable workers only find work in the prime of their youth and manly strength and suffer privations in old age.

Since religion and humanity enjoin us not to let anyone die of indigence and all Governments have recognized it as their duty, too, then all those whose work and products do not suffice to cover the cost of the necessities of life become a public charge and have to be supported by the poor-relief fund. Yet the number of persons in need of help may finally increase so much as to render the provision of support a crushing task for the prosperous.

At the present time, this is indeed the situation in Ireland where thousands of people are

starving to death despite the immense support to the amount of 50 to 60 million talers generously presented by the English to their brother nation.

The current distress in Ireland originated in the simultaneous failure of the potato and grain crops. However, it can be predicted with certainty in the event of a continuation of the irresponsible expansion in population that this distress will return after a few decades even if harvests prove to be good. The situation will then become completely incurable.

These reflections rest on the assumption that capital and area of land under cultivation will retain the same size. But it is easy to demonstrate that, even if the latter does expand – but at a slower rate than the increase in population – the same results will ensue, albeit later.

Peace brings prosperity, prosperity leads to overpopulation and overpopulation creates penury. How can one escape from this vicious circle?

And, we must ask ourselves, is it intended after every short period of peace, recovery and flourishing affluence that most of mankind should invariably head once more for penury?

Is it the design of Providence that as the working population grows, so the future shall appear more and more sombre, distress ever greater and inescapable? That is assuredly not the case.

But what then are the conditions in whose fulfilment Providence has reposed the happiness of mankind? That is the great problem stretching before us. We point to its existence, but we cannot go into the sensitive research it calls for at this stage.

The adoption of a proper attitude to this issue could serve to remove many of the aberrations to be found in the Socialists' proposals. Let the Socialists direct their whole attention towards making work more productive. If they succeed in this, they will truly improve the workers' lot.

The Social Question

Walter Eucken

1948

The chief social issue of the 20th century is quite different to that of the 19th century. It is not only quite different, but also more problematic.

The Social Question of the Nineteenth Century

1. «The predominant social conflict of our age is that between the entrepreneurs and the industrial workmen». These words were written by *Gustav Schmoller* at the end of the last century. He was perfectly right in his thesis. This great social question had emerged at a time of rapid industrialization and mechanization and in the wake of the great liberal laws enacted at the end of the 18th or beginning of the 19th centuries. There were free contracts of employment, freedom of movement and guarantees for private property. But whereas people's freedom and equality of status appeared secure in political and legal terms, industrial workmen were not in fact free either economically or socially. In their dependence and search for an easily identifiable target, workers saw themselves as being at the mercy of the «omnipotence of capital». This predominance was noticeable on the labour market and in individual enterprises. The social question of the early and mid-nineteenth century was compounded of miserable living conditions, inadequate wages, long periods of work, impairment of health, children's labour and an uncertain livelihood for many factory workers. These conditions have often been described and exposed in deeply moving accounts. Society divided into two mutually hostile groups. The social question of that time was more than a crisis in one sphere of life. It became the central issue in society, in domestic politics and in culture.

2. *Marx* devoted the whole force of his passionate nature to the social question of his epoch. He saw in it the driving force behind the advance of history in conformity with certain natural laws. At the same time, he focussed the whole process on one particular point – the ownership of property.

Marx attempted to show that private property could differ considerably, depending on whether the owners were workers or non-workers. He argued that the workers's private ownership of the means of production was the basis of a small-scale enterprise and that small enterprises formed a prerequisite for the development of social production and the free individuality of the worker himself. But this type of private property pushed beyond its limits. *Marx* wanted it eliminated: «it must be destroyed». He believed that a transformation had taken place. Private property owners and workers had become divided and there had arisen a «capitalist private property» based on the exploitation of other people's labour, even though they were theoretically free to offer their services where they liked. The expropriation of the old private owners, who themselves also worked, was then followed by the expropriation of the smaller capitalist private owners. Each capitalist got rid of several others so that the private ownership of the means of production passed into ever fewer hands. The constantly dwindling number of capital magnates increased the scale of misery, of pressure, bondage, degeneration and exploitation – and also the indignation of the united and organized working class. *Marx* saw the social question in this light and he thought that it would inevitably force a solution to be found. He considered the monopoly of capital as shackles on the type of production which had prospered with that monopoly and under it. The centralization of the means of production and the socialization of labour were reaching a point at which they became incompatible with their capitalist shell so that this would be burst open. The last hour of capitalist private ownership had come. Hence, capitalist production would bring about its own downfall with the inevitability of a natural process. According to *Marx*, the social question would be resolved by the automatic disappearance of capitalist private property and the emergence of communal property. In other words, he thought of the social problem and the property problems as constituting one issue.

3. In point of fact, this social question came nearer to a solution by other means during the 19th and early 20th century. The worker's living conditions improved considerably and wages rose three or fourfold in real terms in many industrialized countries.

This result was primarily brought about by economic and technical advances. The better the mechanical equipment available to the workers and the greater his production, the higher the wages which could be paid to him. At the same time, the improvement in transport facilities with more railways, motor cars, bicycles and so forth led to the breaking up of numerous monopolistic or partially monopolistic labour markets. The catchment areas of the industrial firms now began to overlap and workers began to benefit more and more from intracompany competition for staff. Other factors were protective labour legislation (Factory Acts), the prohibition of child labour, the statutory reduction of working hours, the inspection of factories and insurance against sickness, accidents and invalidity. In addition, the workers organized mutual assistance institutions and trade unions, which brought about such changes in the pattern of the market that monopolistic or partly monopolistic providers of demand found themselves confronting partly monopolistic suppliers.

Admittedly, this did not solve the social question of the 19th century completely. Contrasting differences remained and workers were still beset by uncertainty – above all in times of crisis. The mounting concentration of industrial power in combines and marketing cartels heralded the advent of the new social question. Furthermore, the social policy pursued at that time also contributed to the emergence of the social question of our century.

The New Social Question

1. The great social question of our time stands clear for all to see. Industrial workers – and others, too – have become dependent on the State machinery and on numerous public bodies. The contract of employment has in many countries become a contractual relation-

ship in public law with the terms and conditions being determined by the State. An individual worker no longer has a free choice of jobs. He is subject to an obligation to work where he is sent to. The employment exchanges assign him to a specific workplace. He obtains his food through a centralized system of distribution and the same applies to his accommodation. In the event of sickness, accident, invalidity or unemployment, he has to rely on state insurance. A new type of human being is evolving – a mass product dependent for his existence on the State. The whole of life is gradually being nationalized.

And this turn of events is accompanied by the severe damage now being suffered by the direction of the economy. True, the steering of the economy was often inadequate during the preceding stage – as the crisis and depressions have illustrated with abundant clearness. But now the unsatisfactory steering of the productive process has made itself felt among the various nations and in international relations in the form of chronic undersupplies to wide sections of the population, who endure an inadequate flow of consumer goods despite full employment. As soon as the steering mechanism in a modern economy fails to function, the social question assumes greater poignancy.

2. The new social question of our time is not only a question effecting industrial workers, it also extends to all occupations – farmers, craftsmen, merchants and the learned professions. All of them are threatened by this development.

In the 19th century, the social question virtually became a private matter. It was customary then for employers and employees to conclude a private hiring agreement. In economic terms, the unfavourable position of the workers stemmed primarily from two determining elements. Industrial operatives often had to offer their services in a market characterized by partial or complete monopoly of demand, which conferred a superior position of strength upon the employers. Secondly, the supply of labour on the market often proved to be anti-cyclical. Once that wages began to fall, more workers – above all family members – appeared on the market and wages fell still further.

Today, the social question is no longer of a private nature, since this also disappeared when the private character of modern life came to an end. Employment contracts are now governed by public law and in economic terms it is no longer the market which decides – i. e. an exchange of work for money – but the assignment and allocation of jobs and consumer goods. Many countries have transformed their largely free exchange economies into centrally planned systems.

3. This change of economic order raises some major economic issues. But not only that. The situation also reveals the correlation between the various systems under which modern man lives. The change in the economic set-up has also altered the social order of other systems to a radical degree. The more that central planning of the economic process gains acceptance, the more that society will be shaped from above. Every social order is pyramidal in shape. There is always a leading class. There never has been a «classless» society and there never will be one. As *Pareto* once expressed it, there is always a layer A and a layer B. However, the pyramid can be built up from below or the leadership may decide how the lower levels are to be arranged. Either families or spontaneously evolving local administrations or co-operatives etc. may become the leaders of society or else these entities are created from above or directed from above.

The more that an economic system develops towards a centrally administered economy in which the officials of the central administration represent the leading echelon, the more that society loses its organic character. The masses do not comprise a certain social class: they represent a certain condition in which people can find themselves. A depersonalization of individuals is particularly probable when society undergoes the reshaping of which we have been speaking. As a result, every occupation acquires a new character – whether we are thinking of farmers, craftsmen or merchants, of manual workers or office employees. Society does not arise from spontaneous forces: it is steered from above and its organization depends on instructions issued by the officials in central agencies.

4. The State has a special role to play in this historic process. Moreover, it does not act independently of pressure groups such as those of industrialists, farmers or workers, who contrive to exercise varying degrees of influence on governmental decision-making. That is a peculiar and controversial feature of the reorganization of the modern State in the 20th century. It expands its power base by a myriad encroachments on the everyday economic process. But at the same time, it falls more and more into the hands of economic pressure groups – whether these be trade unions or farmers' associations or industrial pressure groups in the guise of trusts or cartels or other industrial organizations. These powerful groups not only actively control governmental policy-formation, but also take away some of the important sectors of the State's former activities. As a result, the provisions of an industrial group's internal statutes often supersede national laws. In many sectors, the arbitral tribunals set up by power groups have displaced the proper courts. Private courts also possess considerable authority, albeit in different fashion to former times. They exercise their influence above all in conjunction with the Government. The representatives of private pressure groups often hold positions in central administrative bodies so that the State is thus drawn into the machinery of powerful groups.

The livelihood of most of the population rests in the hands of this unstable entity – a situation which assumes all the more gravity because modern man largely accepts the rule that the State is not bound by any moral laws. The greater the State's instruments and scope of power, the more dangerous the doctrine becomes that governments can dispense with ethical precepts. Where the State presumes to be the measure of all things and simultaneously proclaims its own amoral nature, it is less entitled than ever to the ethical leadership of the nation. A State which claims to be above any ethical considerations has declared its sphere of action to be the asylum of depravity and it attracts the eternal evil in man like a centre of gravity (*Huizinga*).

5. But the new social question, the oppressive dependence on this State, the extraordinary danger to human freedom, the transformation of man into a mere cog in a large machine, the fresh wave of economic and social uncertainty flowing from this subordination – all these problems cannot be resolved by the State simply standing aside and leaving the whole economy to private enterprise, i. e. returning to the conditions of the 19th century. In the meantime, industrial concentration has accelerated with the State rendering a major contribution to this process; and there is now a danger that deliverance from the predominant power of the State will put many people at the mercy of private centres of power.

A free economic and social system does not arise of its own accord, especially during the age of industrialization and mechanization. That is one of the lessons manifestly taught us by history. In the late 18th and the 19th centuries, people recognized that political freedom ought to be backed by constitutions containing prudent guarantees and legal freedom by codified laws. At the same time, they believed that a truly free economic order could evolve of its own accord. In truth, the principles governing a well-functioning and free economic system resemble those for the State and the legal system. The structures of economic growth cannot be left to *laissez-faire*. The question of whether monopolies on the labour markets or other positions of power in trade and industry come into existence and the question of how monetary economies develop among the various nations and on the international scene must not depend on chance and on the self-interest of those engaged in economic activity. It calls for planning, but this must confine itself to the forms of economic activity and ensure that these do not develop within the economy in such a way as to jeopardize the dignified and free existence of men and women going about their daily tasks or as to prevent any rational steering of the overall productive process.

1. The profound contrast between the major social questions of the two epochs still persists. But the problems, the definitions, the ideas and the programmes in circulation in the world today mostly stem from the last epoch, i. e. from the social problems of the 19th century. Most people believe that they can resolve today's quite different social questions by applying the 19th century's instruments of social policy. This philosophy persists in a world which is no longer realistic. If a steamer passes by on the river, the waves often lap the banks long after it has passed from sight. This also holds true of those ideas which rule today's economic and social policy. The nineteenth century may have passed, but the ideas which originated in that age still retain their validity.

The anachronism of the prevailing ideas of contemporary times is another undeniable historic fact. If we are to overcome this anachronism and pave the way for a true comprehension of the social question as reflected in the realities of our own century, then we must recognize it for what it is. Let us try to describe it from at least two angles.

2. The anachronism becomes most explicit of all in regard to property. Even *Marx* had peculiar views about property. With a keen insight into the economic forces of his epoch, he grasped the full significance of economic power in an environment in which people enjoyed equal political status. The fact that private economic power often went hand in hand with private property did not escape his attention, either. To that extent, he was a realist. But he was ignoring the lessons of the past when he suggested that economic power could be eliminated by collective property. In that regard, he was a dreamer.

The contemporary era is dominated by the antithesis between private property and collective property – an issue handed down from the battle of ideas which took place in the 19th century. The argument adduced is as follows. If private property often resulted in the creation of positions of economic power and exploitation and if it was the main factor behind the social question, then it seemed quite right to attempt to resolve the social question by eradicating private ownership of the means of production and by introducing collective property. That was the argument used. The major nationalization and socialization schemes of recent decades took place on this basis. Many countries have experienced the creation of mighty combines embracing numerous – often many hundred – companies in various branches of industry. By the same token, whole industries are sometimes nationalized such as coal mining in England and France so that enormous state monopolies arise. The belief is that the transfer of economic power from private enterprise to public authorities will bring about an improvement in social administration.

In consequence, the process of industrial concentration is entering a new phase. Enlarged public combines and public monopolistic administrations are replacing private groups of firms and private cartels in many places.

Spellbound as they are by the ideas of the 19th century, modern economic policy-makers cannot achieve the desired goal. Their views contradict an old historic experience, whose validity has been reaffirmed in our present age. Those problems, bound up as they are with political or economic power, cannot be solved by concentrating power still further. Nations and epochs noted for their political wisdom knew that power and domination or threats to individual liberty can only be effectively combated through splitting up the centres of power and not through a further accumulation of power. However, nationalization and socialization usually produce a double concentration. Different spheres – the economy and political decision-making – are linked together with a resultant aggravation of the problem of predominance and social dependence. At the same time, the scale of nationalization of socialization in the economic sphere itself increases the centres of power as a result of the amalgamation of large or even smaller private enterprises to form large state-owned entities. Broadly speaking, this economic policy of socialization and nationalization moves in a

direction calculated to enhance dependence and bondage and to render the current social question even more acute.

The rejoinder to this argument is that the State is often controlled by parliamentary bodies and therefore subject to the supervision of the people. But as we know from our most recent experience in particular, a far-reaching nationalization or socialization alters the character of the State insofar as the administrative apparatus gains ascendancy and renders impossible any effective control over the bureaucracy in charge of publicly-owned industries or enterprises. What remains is individual dependence on the anonymous supremacy enjoyed by nationalized firms and branches of the economy.

Nor can the monopoly problem be resolved by nationalization or socialization. On the contrary, past experience has taught us that state monopolies such as the railways pursue a monopoly policy which is just as resolute as that of private monopolists. Indeed, these entities often display greater determination in their exercise of power. For the heads of monopolistic entities believe their policies to be justified by the fact that they are devised to promote the public interest i. e. that of the people. In actual fact, they pursue their monopolistic schemes irrespective of any damage caused. Here, too, it avails nothing if workers' representatives are given seats on the management boards of nationalized industries. As the events surrounding the Coal Industry Act introduced in Germany in 1919 showed, the workers of one group are always willing to support the monopolistic claims of their industry in order to improve the social position of their own colleagues. In this way, one section of the population gains favour at the expense of all the others. The vast problem of regulating economic and social power – a problem whose resolution is indispensable if we also wish to settle the social question – remains unsolved.

3. Similar to the problem of property, the task of directing of economy is mostly tackled in the spirit of the 19th century.

Let us consider, for example, the teachings of Saint Simon, whose followers shaped a philosophy of the problems of «socialism» more than anyone else. For them, the economy is anarchical in an age of *laissez faire* and free competition – two terms which they see as identical. To the Saint-Simonists, competition is a phenomenon of the critical age in which we live and one marked by a wasteful use of capital. As soon as the rumour circulates that a certain branch of industry furnishes good chances of making a profit, capital and labour blindly hasten to join in. When it subsequently emerges that serious errors have occurred, we ask ourselves what the outcome of all these cut-throat struggles really amounts to? A handful of successful entrepreneurs enjoy their triumph, but the price of this is nothing less than the financial ruin of numerous victims. The inevitable consequence of such exaggerated and rampant production is a severance of the link between production and consumption. The roots of innumerable catastrophes and economic crises lie here. The argument further runs that competitors lack an overview of the whole ambit of business activities, since everyone has to rely on his personal experience. No-one obtains any general survey of production so that the latter proceeds without either differentiation or foresight. In some places, too much is produced and in others too little. When so many disturbances take place in one major sector of social activities and so much confusion prevails, that comes from the distributing of the means of production by isolated individuals, who know neither the needs of the economy and of people nor the means needed to satisfy them. But the anarchy of production and distribution in the critical epoch in which we now live will resolve itself in the course of history. Competition is not merely a bad thing in itself, it is also incompatible with the natural train of events and therefore antiquated. A new coherent social order will arise with a central direction of the economic process in which men in positions of leadership command a general view of the overall situation and can steer affairs in a rational manner.

Under this argument, the antithesis between private and collective property is supplemented by the antithesis between anarchy in individual production and control of the economic process by central governmental agencies. The final argument adduced by the

Saint Simonists is as follows. Although individual enterprise and private property may be characteristic of the present epoch, the future will bring central controls and collective property.

Following the great advances in economic theory during the last hundred years, it is not difficult to repudiate these ideas on the anarchy of the economic process and the overcoming of anarchy by central direction. As we know today, *laissez-faire* and perfect competition must not be confused with each other and *laissez-faire* very often produces different market structures than those under a *laissez-faire* régime. We are also aware that the direction of the productive process differs considerably depending on the structure of the market; that no real equilibrium ensues in certain types of market such as an oligopoly or a reciprocal monopoly; and that the equilibrium attained in other market structures such as a monopoly of supply or perfect competition possesses a different character. Economists have also demonstrated that the price mechanism not only functions differently pursuant to the given type of market, but also pursuant to the type of monetary economy. The crises and depressions of the 19th and early 20th centuries often came about or worsened because the chosen monetary economy failed to operate properly. Yet it was not the price system as such which failed as a steering instrument; it was prices which failed after they had developed pursuant to certain market structures or price-fixing or inadequate monetary economies. In other words, economic policy-makers should attempt to bring about market structures and monetary economies which permit as precise a direction of the productive process as possible and one designed to fulfil man's wants.

However, not only the criticism of the allegedly anarchical productive process was too blunt and therefore inaccurate. Our latest economic research has shown that the other side of the argument was equally untenable. The Saint Simonists and many others after them believed that the establishment of central controls for the productive process would overcome «anarchy» and render a rational steering of the economy feasible. That, in turn, would also help to solve the social question. However, both scientific analysis and practical experience have shown what major problems arise as soon as central administrative bodies wish to direct a country's economic process.

The installation of an adequate steering mechanism into centrally planned economies proved to be an earnest, albeit insoluble proposition. The danger of anarchy, a misdirection of capital and an indiscriminate placing of investments was not overcome as hoped: it grew worse. Furthermore, this introduction of central controls and planning resulted in a concentration of economic power, because the productive process was governed by the plans drawn up by central agencies rather than those of individual entrepreneurs and private households. Moreover, it was accompanied by the introduction of compulsory national service, constraints on freedom to move from place to place and to change jobs etc. All activities became the responsibility of the central administration and it was this factor which the economists examined with particular attention.

But public opinion still believes that a steering of the productive process operating pursuant to the individual plans of private households and firms must be chaotic. Most people are unaware of the differences between market structures. Only a few experts know how carefully the economic process is piloted under a system of perfect competition. Little is known about the complex relationship between the monetary system, price formation and the control of economic life. Wide circles of the population still believe in the necessity of central planning in order to provide the economy with a sense of direction. The majority of people in many countries adhere to ideas which created a stir in the 1820s. The fact that these no longer accord with the realities of today is gradually being recognized. An unprejudiced onlooker, surveying this scene, may well recall Goethe's wise words: «we all live from things past and that is our ruin».

Needless to say, these outmoded ideologies are also instruments in the hands of certain groups of functionaries fighting to gain power or to defend their positions.

4. A glance at this situation makes it easier to understand the proposals for avoiding, by means of a deconcentration of planning and the splitting up of collective property, the social and economic dangers which a centrally planned economy and concentrated collective property involve without actually abandoning them altogether. Would it not be possible, the question usually reads, to relax central controls by transferring this responsibility to self-administering bodies or organizations set up by the various industries such as coal mining, iron and steel, textiles etc? Or perhaps to local authorities or self-administering bodies to whom higher-ranking agencies merely give general instructions?

However interesting these proposals may be in themselves, they fail to take one important aspect of a modern industrialized system into account. The economic life of a nation and indeed of many nations together forms *one* coherent whole. This organic, sophisticated and varied process must be steered in some way. Every hour worked by every labourer and every single part of the means of production must be combined with the myriad other production requisites and hours of work in such a manner as to provide an optimal satisfaction of demand. Only in this way can we overcome social and economic distress. Every enterprise and every household is directly and indirectly connected in a thousand different ways with innumerable other enterprises and households. This circumstance is not taken into account under a so-called deconcentration of central planning. If one administrative unit draws up its own plans for coal-mining, another one for coal and steel and a third one for textiles, the productive process will soon consist of an anarchical co-existence of groups of monopolists. These individual plans do not interlock in a rational manner and, all in all, the economy resembles a ship without a rudder. The alternative is to place these self-administering bodies under central direction. In that case, unity may be maintained more efficiently, but self-administration only exists on paper. The central agencies and bodies of the various branches of industry have become instruments for a centralized administration and the deconcentration of the centrally controlled economy has miscarried.

But how can one contrive to thin out collective property? Could one perhaps transfer the ownership of the means of production to co-managed bodies for industry with workers on management boards? Or to local authorities? On the other hand, every conversion to collective ownership signifies a strengthening of concentration and a stabilizing of positions of power – even if collective property is restricted to certain branches or localities. It merely aggravates the problem of monopolies rather than solving it.

Alternatively, could one perhaps introduce state ownership of the means of production whilst leaving the steering of the economy to the forces of unrestricted competition? That would establish markets and the state managers of individual firms would be told to behave as if they were competing against each other. That would imply that the very same State which began by taking over all the means of production was depriving itself of its own power in using this immense productive apparatus and submitting to the plans of the consumers as regards the direction of the economy. Quite apart from other major difficulties, that is a proposal which, on past experience, simply cannot be translated into reality.

We can think of this situation in the following way. The 19th century saw the establishment of an edifice of ideas based on the concept of collective property and the central direction of the economy plus a number of other ideas. Many people believed that they would be able to live in this building free from the pressure of the social question and relieved of a sense of uncertainty and distress. This edifice of ideas was erected on the foundations of a belief in an automatic development process. But nowadays, life in the building has become different and the residents sense the loom of bondage and deprivation of social rights. For that reason, the suggestion has been put forward that a number of facilities should be added to avert the dangers. But these do not help the old building nor do changes in the technique of central controls or the administration of collective property. However commendable the motives behind such proposals may be, they merely conceal the real social question of our age.

5. Without freedom of movement, free choice of workplace, free contracting of employ-

ment and the terminating or weakening of unilateral positions of socio-economic strength, there can be no solution to the social question. But then, it is not the central planning agencies but the individual households and firms with their individual plans who must direct the day-to-day running of the economy. None the less, it is not a matter for commercial enterprises and private households to determine by themselves the framework within which the economic process operates. The duty of ensuring the adequacy of labour markets and commodity markets devolves upon the State. In this field, it undertakes a task which it is capable of resolving, whereas the State will certainly fail if it attempts to control the productive process itself.

A co-existence between the decisions of the central agencies and the individual households or enterprises, i. e. between a centrally planned economy and a free exchange economy, does not result in the desired synthesis between «planning» and freedom. If an employment exchange allocates a workman to a certain job under a centrally controlled system, this obligatory assignment may or may not happen to correspond to his wishes and plans. By the same token, investments based on centrally controlled allocations of personnel and production equipment cannot take place *simultaneously* with the personal decisions of industrial entrepreneurs and bankers. Experiments undertaken in this vain attempt are like trying to have several orchestras playing at once in the same hall in the hope of somehow achieving harmony. Our approach must be a different one. The structures designed to accommodate the sequence of economic events require continuous governmental supervision and possibly organization in an age of industrialization. But within these commodity and labour markets – in other words, in everyday economic life – there must be freedom. That is the real goal. Without freedom, there can be no solution of the social question. That creates a basic assumption underlying the social organization of working regulations – a precondition which is lacking if the workers on the labour markets are confronted by monopolistic employers or public authorities. There is a close relationship between power on the labour markets and power in industrial enterprises. Under a proper marketing system, it becomes impossible for individual freedom to degenerate into the arbitrary domination of many by a few.

Admittedly, this only makes up part of the framework which ought to be erected in order to resolve the social question. Other measures – of a monetary, commercial and legal nature – also form an indispensable part of this framework. As a result of the general interdependence between all markets, the social question can only be resolved by means of an adequate overall system. And so the social question becomes part of the major issue of consummating an adequate and free economic system. Social reasons, in particular, indicate that there is no alternative to free competition. However, it is only possible to outline the task and to say what the social question consists of and what it does not consist of.

6. The anachronistic mentality prevalent among wide sections of the population – including many intellectuals – means that they do not notice what is taking place before their eyes: manual workers and office employees and most of the other professions are socially weakened by the elimination of the free employment contract and freedom of movement and their replacement by compulsory allocation of labour, socialization and central planning. At the same time, people become part of a machine or fall into the hands of officials who then proceed to tyrannize them. There still prevails a widespread illusion that central direction is «social». *Ranke* once spoke of striving to give a clearer, more unmistakable and graphic quality to the moment of world history in which we find ourselves. That is what we should aspire to. Let us take a look at private households and enterprises. There we shall see what the social question really amounts to at our point in history. We shall achieve clarity about how the concentration of property and the steering of the economy by the State and other public authorities permanently impinge upon private enterprise, how the flow of goods deteriorates, how individuals are depersonalized as compulsion and dependence spread, how a sense of individual responsibility diminishes and how the development of those resources which inspire men and women to personal endeavour are put at hazard.

Safeguarding the Social Market Economy by a Systematic Regulative Policy

Wolfgang Stützel

1978

I. Two Economic Methods: a Therapy to Cure Symptoms versus a Fundamental Corrective

Broadly speaking, a policy-maker who feels impelled by unacceptable developments in the economy to take action for remedying them will have a choice between two completely different approaches.

Let us take as an example the times when we still operated the old all-phase turnover tax in West Germany (charged at every stage of production and sale), a tax which did in fact result in unacceptable developments. Whenever production in successive stages was carried out by different enterprises, each with a separate legal personality, the final product attracted a very large incidence of turnover tax. Conversely, if an entrepreneur united several stages of production within one firm, he attained considerable tax advantages. In other words, the then valid law had established a differential in profits which positively encouraged an undesirable vertical concentration among commercial enterprises.

For a long period of time, legislators and administrators alike applied method No. 1.: they tried to cure the most conspicuous symptoms. For instance, weaving mills were treated as if they consisted of two firms. Special rates were conceded as an exceptional provision. Nevertheless, vast differences in the burden of tax persisted – depending on the type of vertical concentration. Clearly, this sort of procedure represents a short-sighted and merely ad hoc therapy.

Following the preliminary work carried out by *Curt Becker*, the legislators were however forced by the Federal Constitutional Court to take a closer look at the situation. The Government was called upon to eliminate the whole differential in profits. As a result, the present value-added system was introduced to replace the all-phase turnover tax. This

seemed seemed a prudent and fundamental correction and improvement of the existing system.

Some economists prefer to use other terms when describing this situation such as «ad hoc measures versus a genuine regulative policy». Others speak of «discretionary interference» and contrast this with the binding of private enterprises by certain rules. I myself prefer to use the expression «an ad hoc therapy of symptoms versus a fundamental correction of the system».

At all events, this distinction possesses enough significance in any analysis of the wide-ranging economic issues which confront all of us as to justify the wish to illustrate it by a number of further examples.

Let us, then, take a second instance. During the first half of the 1960s, the public authorities all over West Germany had large cash holdings. At that time, banks were only allowed to pay their customers modest rates of interest on their deposits pursuant to the regulations of the Federal Supervisory Office. As a result, the banks queued up outside the public authorities' offices to be the first to enjoy the blessings of this plentiful flow of cheap money – cheap because of the rules on maximum interest rates. In brief, the banks started squabbling like hens around the feeding trough trying to determine the pecking order. That was a signal for the civil servants in Bonn to step into the breach and to work out detailed provisions for an equitable distribution of such public deposits. This clearly represented an example of method No. 1, i. e. merely treating the symptoms. The officials set about planning a large number of new paragraphs to supplement the existing laws. I myself was officially appointed by the German Government to give my comments on various drafts of new provisions. My answer was invariably as follows: abolish the rules controlling the level of interest rates and then the matter will settle itself!

In 1967, the controls on interest rates finally disappeared. Since then, there has been no more talk of the economic problem inherent in the equitable distribution of public funds among the various banks. The pecking order on the free market pursuant to the principle of «whoever pays the highest interest gets my money» has rendered any bureaucratic allocation scheme completely superfluous. This is obviously, an instance of method No. 2, the application of a fundamental corrective and prudent regulation instead of makeshift measures. The vast jumble of legal provisions needed to establish a fair system of handling the public authorities' bank deposits if the controls on interest levels had remained was one nightmare which we were spared.

Let us take a third example – our traditional balance-sheet law. Under its provisions, a great many items, claims and debts have to be punctually entered in the balance sheets. On the other hand, very many items including matters of importance do not need to be formally recorded. To these belong the conclusion of contracts of purchase, tenancy agreements and employment contracts. An entry is only necessary in the financial accounting records and in the balance sheet if one of the two parties has effected a prepayment. For centuries, claims and debts under mutually non-fulfilled contracts of this type have not been recorded in firm's books.

The authorities naturally set great store by balance-sheet figures – nowadays more than ever – because they use them for computing a wide spectrum of items ranging from the trading capital tax to banks' minimum reserve obligations. But practical-minded businessmen naturally try to make the most of this situation. Wherever the same objective can be achieved via a different route i. e. by a method whereby items do not need to be shown in the balance-sheet, then businessmen promptly opt for that system.

Let us take as our next illustration a bank. Instead of taking deposits, the bank may sell the customer a security and immediately agree on later repurchase at an agreed price. This is known as an *en pension* transaction. Its chief implication is as follows. The obligation otherwise devolving upon the bank to repay the investor the money designated as a deposit will of course have to be shown in the balance-sheet. On the other hand, the bank's

obligation to repay the customer this money under the heading «payment of the security's repurchasing price» need not be entered.

The Government reacted to this situation by method No. 1. By dint of lengthy special provisions issued by the Federal Bank, on pension transactions taking place in certain circumstances subject to the control of the bank supervisory authorities were accorded the same status as normal deposits.

Let us take another example of side-stepping the regulations, this time in an industrial firm. Instead of taking up a long-term credit for procuring machinery and then buying the desired machines, the entrepreneur simply rents the items under a leasing arrangement. The debt in respect of the loan would have been recorded in the balance-sheet, whereas the leasing transaction remains invisible.

Here, again, the Government merely reacted with ad hoc methods. The tax laws have meanwhile been supplemented by numerous paragraphs designed to prevent an evasion of the trading capital tax through leasing.

In connection with the legal requirements for bookkeeping, let us cite the case of the Herstatt Bank. In earlier years, it was customary to speculate in forward currency transactions with an exchange of bills – the classical swap deal. Each of the participants entered a «bill payable» on the one side of the balance-sheet and a «bill held» on the other in another currency. The risk attendant upon the transaction was immediately discernible in the balance sheet. But here, too, businessmen sought to evade this established procedure. Today, everyone engaged in this type of speculation enters the transaction as a simple purchase of forward exchange so that it does not need to appear in the balance sheet. As a result, forward dealing amounting to billions of marks in the Herstatt affair were not entered in the books – just like analogous items in all other banks including the Bundesbank. Only a handful of persons knew of these transactions. Here, too, the Government decided to act, although only after the child had already fallen into the well. Once more, the reaction was true to type: a spate of heavy-handed provisions.

My personal impression is that we have long since reached the point at which it would be advisable to undertake fundamental measures to overcome this predicament by enacting the requisite decrees. Moreover, all claims and liabilities under the type of contract described above must be shown in a balance sheet.

That would be a step towards establishing the orderly relationships which we really need in commercial life. This single legal principle i. e. that a firm must list in the balance sheet all lendings and liabilities in respect of unfulfilled contracts would make a large number of legal provisions under the old ad hoc system completely unnecessary.

Such a legal obligation for all debts and claims pursuant to mutually non-fulfilled contracts would produce highly interesting implications in regard to the most recent changes in the wages sector i. e. the agreement to protect employees against the consequences of rationalization. The liabilities under the existing work contracts would have to be entered in the balance sheet with the discounted cash value of the total amount of wages expenditure expected up to the earliest possible termination of the expected sum recorded as liabilities. And something like that can be estimated, just as auditors or tax-office investigators sometimes assesses similar matters. The assets would consist of the discounted cash value of the claims to services under existing work contracts. It would be up to the auditors to estimate whether these assets covered the liabilities in value terms.

This fundamental change towards recording all unfulfilled mutual contracts would mean that every nuance of additional steps to secure a greater income for the employees would become immediately discernible in the balance sheets. Every extension of periods of notice would have to be shown in the balance sheets as an increase in the existing payment obligations. That would immediately indicate what additional burdens and survival risks such agreements would actually entail for the enterprises concerned.

The Herstatt affair ought to be a warning for all of us. The Government should take steps

to offset risks by arranging for complete transparency of bookkeeping records, and do so before the child falls into the well. That would serve as a good example to illustrate what we have been taking about: a systematic and prudent policy to regulate the economy.

Requirements of the Social Market Economy

When readers see the expression «regulative policy», most of them have hitherto probably associated this with other topics so that they are surprised to find me mentioning it in this context. They understand by the term such topics as «steering production by freely fluctuating prices or by bureaucratic methods» or «competitive policy» and «consumer protection». I have deliberately begun with sectors in which this whole subject has, at first sight, little relevance: turnover tax law, banking law and bookkeeping law.

The Need for a Prudent Regulative Policy

This is my first subject. In all these sectors from bookkeeping provisions via capital formation policy and environmental protection to regional policy, the important thing to bear in mind is the following. If we wish to keep our economic system transparent and measurable, we must abandon all short-sighted and ad hoc therapies designed to cure the symptoms only and opt for a circumspect and fundamental rectification of the whole system.

Let us now turn to the two central themes of all regulative policy. How should production be steered and how should products be distributed? Here, too, we face the usual choice between simply trying to remedy the symptoms or carefully undertaking a thorough improvement of the situation by fundamental measures.

The postwar history of the German economy is marked by the comparative speed and precision with which the steering of production was systematically and thoroughly revised. This does not hold true of distribution. Admittedly, some aspects of the system were improved such as the introduction of the principle that old-age pensioners should be protected against inflation by their pensions being index-linked to the production increases achieved by the gainfully employed. It is worth noting, however, that the social welfare sector was characterized by a large number of short-sighted ad hoc therapies suitable only for tackling the symptoms.

This difference begins with the intrinsic concept of a market economy and its implications for the steering of the productive process. The adherents of a market economy entertain no doubts in their own minds about what method of steering is meant: that of the final consumer and a free interplay between market forces and prices.

Social Correctives Outside of the Price System

But how «social» is in fact the social market economy? For a long time now, there has existed an inherent defect or «deficit» in the programme.

This was overlooked during the first vigorous upswing of the economic miracle, because people were so pleasantly surprised about the country's material achievements. It remained neglected during the following period of ardent reforms and visionary schemes. Only now when we are concerned to safeguard our very high standard of living and when many worries force us to review dispassionately the accretions which have taken place during the boom times is the shortcoming becoming more and more evident. This shortcoming may be delineated as follows.

Even thirty years after the inception of the Social Market Economy, those men and

women dedicated to solving social problems are still not sufficiently aware of what procedures have to be adopted under a free economic system in order to guarantee the attainment of what is socially desirable.

The «market economy» part of the system is clearly articulated and easy to operate, whereas the «social» aspect has not been enunciated with sufficient energy. It is high time that we should do something about this.

It is high time that everyone should know beyond doubt how the special tasks inherent in the achievement of a social balance should be fully and precisely fitted into our market economy. The simple formula of «help for those who practise self-help» or «as much private enterprise as possible and as much State as necessary» do not really satisfy us. What we need is a more precise determination of suitable methods.

As I have already pointed out, there still persists a great deal of vagueness about the conceptual side of Social Market Economy and this is reflected in its de facto progress.

The only major reform of our economy designed to promote harmonious social market system has been achieved in the organizing of production. As regards social welfare, however, there still prevails a wide measure of vagueness about the appropriate instruments and their likely impact.

Among the instruments, we find the device of charging special prices for needy persons, i. e. price-cuts on the one hand matched by additional charges on the other. Secondly, we can see (in the shape of hospitals, old people's homes, swimming-baths, publicly-assisted housing and the locating of industries in development areas) the device of high direct subsidies to producers and public bodies who provide what is urgently necessary in social terms without being at all certain about the effectiveness of this use of funds in regard to the intended social purpose. Furthermore, tax-revenue and other imposts are paid out to necessitous people under various headings such as subsidies and other disbursements of the most varied kind. In other words, there exists a well organized apparatus for a purposive fiscal adjustment and redistribution of income.

An Alarming Lack of Lucidity

In brief, the prevalence of special prices on the one hand and producer subsidies on the other together with diverse systems of fiscal-adjustment have raised the complexity of the whole system to frightening levels.

And what has been the impact of all this? For a long time, the free market economy enjoyed the reputation of being a system which remunerated those entrepreneurs who proved best able to estimate the needs of the consumers, who organized their firms most economically and who ferreted out the most promising lines for the future. A market economy was also commended as the system which remunerated those workers and employees who showed themselves most capable of meeting the new technological challenges of our age.

In the meantime, the sheer intricacy of these multifarious social measures threatens to turn it into an arrangement for offering the highest rewards to those who develop the most energy in finding their way through the jungle of high-minded social provisions and discover how to exploit them with the greatest dexterity. Hence, the risk is that the highest rewards will go not to the hardworking pioneers, but to the most ingenious and least scrupulous spongers.

The situation resembles the comparatively harmless example of the unsound all-phase turnover tax. In fact, I began with that as an example in order to furnish a readily understandable example. The all-phase turnover tax finally became ripe for scrapping in the plethora of luxuriating legal provisions and it gave way to the value-added tax, which corresponded more closely to the chosen system. But here, too, the number of special measures has multiplied enormously so that the time now seems to have come for another

change. Be that as it may, the value-added tax is undoubtedly superior to the all-phase turnover tax. The grumbles about fostering industrial concentration have disappeared.

With this in mind, we ought to consider what would best conform to the agreed system. Clearly, the answer consists in ending the race between the clever scroungers on the one hand and the notoriously tardy producers of supplementary legislation on the other. The time has really come for bold steps to effect a fundamental reorganization and improvement of the system.

What we need is the translation into practice of ideas which were enunciated by *Alfred Müller-Armack* as early as 1947. And that brings me to my second thesis: we need an absolutely explicit division of functions between prices and the redistribution of income via fiscal adjustment.

The role of prices under this scheme consists exclusively in piloting the productive process. Only that can guarantee the production of what consumers indicate by virtue of their daily purchasing habits and outlay of their hard-earned money as corresponding to their real needs.

However, the requisite social correctives to the distribution of income derived from the productive process ought, if possible, to take place exclusively in the form of the direct transmission of money i. e. open transfers. Social correctives should not be a matter for the price system, but for fiscal adjustment between the various sections of the community. Only that will ensure that redistribution arrangements remain predictable and politically justifiable. Only in that way will the beneficiaries of the system (i. e. the sick, the aged and the needy) acquire a higher income in addition to the freedom as responsible-minded citizens to decide what they wish to use it for. Only in that way will the weaker members of the community genuinely strengthen their voting power on the structure of production. Only in that way can these weaker members ensure that their objectives, including, health care and old-age provision, are attained as economically and as smoothly as possible.

The Boomerang Effect of Well-meant Social Measures

This brings me to my third proposition, which runs as follows. Whenever politicians have attempted to promote social welfare through unrestricted «contributions» and direct assistance to the needy by interfering with the structure of prices or by subsidizing producers, these good intentions have regularly rebounded to the beneficiary's disadvantage: the well-meant measures actually had a boomerang effect.

Almost everyone now knows in connection with a price-freeze intended to favour the consumers of certain goods that this has hitherto always induced suppliers to deploy their resources up to and over the limit of what is legally permissible in respect of an alternative, thus aggravating the deficiency and worsening the position of the customers.

Similar considerations attach to any gradation in wages pursuant to social attributes, whenever employers are constrained to economize on labour. We need only think of a gradation based on family status and the number of children in a family. We have not yet reached that stage, but it may well come about. Even in Yugoslavia where such differentiation was possible in production cooperatives competing against each other, it proved inevitable wherever the employers were forced to adopt economy measures that large families found themselves at a disadvantage compared with childless couples. Here, too, there was a boomerang effect.

Indeed, the postwar period has been characterized by a plethora of social measures which produces such an impact.

During the housing shortage of the first years of peace, the authorities believed that the best way to help tenants and home-seekers was to freeze rents at a low level. A typical illustration of tackling the symptoms instead of the causes! The most advantageously located

sites were immediately seized upon by those who still wielded the weapon of being able to offer higher prices in the race to obtain the accommodation and real estate in short supply. I refer, of course, to the people who were looking for properties for commercial use. Whereas there were no more shortages of foodstuffs, clothing and motor-cars after 1950 due to the introduction of freely fluctuating prices, the housing shortage grew more and more serious.

And then someone hit upon the idea of giving subsidies to the builders instead of to needy tenants – the first scheme being interference with prices, the second producer subsidization – and at the same time imposing upon them an obligatory renunciation of market rents. Yet another instance of ad hoc treatment of the symptoms only. The upshot of this approach was a pack of «subsidy jackals» on the one hand and whole blocks of apartments and dwellings ill-suited to the real needs of the consumers on the other. And that was the response to this infringement of what I call the main principle of functionally separating market prices from a fiscal adjustment between the various sections of the population.

I have cited other illustrations elsewhere including the fields of environmental protection, commuter traffic, capital formation policy etc, but I would like to summarize the whole subject as follows:

The story of aberrations in postwar Germany is a chronicle of grave violations of the fundamental correlation principle under a truly Social Market Economy. Virtually all undesirable developments stem from the belief that the social aspect of the system could be promoted by ad hoc interference with prices or by producer subsidization instead of by a fundamental corrective consisting of an appropriate and direct fiscal adjustment between the different groups of the community.

Faulty Trends on the Labour Market

Today, we face persistent unemployment. Among all the aberrations experienced by our postwar economy, this constitutes the most besetting problem. Accordingly, it is particularly important in the dispute about possible solutions to realize which method deserves priority – a short-sighted ad hoc therapy for the symptoms or a circumpect, albeit fundamental corrective and improvement of the system.

Let me begin by carefully diagnosing the situation. In so doing, I may repeat a number of points already mentioned elsewhere. Nevertheless, there are some things which cannot be reiterated often enough.

After all, there is more at stake than solely the one million unemployed in West Germany: the structure of unemployment bears little resemblance to that in, say, 1931. In the early Thirties, there were few jobless among unskilled labourers as they always managed to find tidying-up work of some kind. But many of the skilled workers had no job. Moreover, the number of people out of work totalled six million compared with one million today. In the early Thirties, there was no shortage of skilled labour – quite unlike the position today.

And now I come to my diagnosis. I adhere to it despite all the criticism which it has attracted. I still contend that the present level of unemployment together with all its characteristics – inception, scale, duration and inherent structure – flows automatically from the interplay between the following five components and that it could have been easily predicted. I say that with every confidence. I can remember taking part in a panel discussion in 1973 when the symptoms first started to appear and stoutly declaring that, if things remained as they were, the outcome was bound to be unemployment. As I write these lines in 1978, we can now compare my prognosis and the reality of five years later.

Employment Costs and Proceeds

The first component takes us back to the years 1973/74 when the growth rate for overall nominal demand dropped substantially. In line with that development, entrepreneurial profits – from which the service of capital, taxes and labour costs are defrayed – increased on a modest scale only. Nevertheless, the total annual operating expenditure needed to employ someone rose to a disproportionately high level. I am not referring to hourly gross or net wages, but to the overall annual running costs for staff. This sharp rise stems from official wage policy and the growth in compulsory fringe benefits provided by employers – whether tangible or intangible (such as giving employees time off to attend staff council meetings).

This is the explanation why, for the last four years, the total income from public and private undertakings has not sufficed to match the overall demand for jobs at the current high annual cost of employment. The annual operating costs of employing someone are rising more rapidly than overall demand – a development inspired by the best of social intentions, but productive of harmful social consequences.

Labour and Capital Costs

The second factor is as follows. Not only in terms of overall demand but also in terms of the cost of capital to replace labour, wages have for some time been too high and thus out of line with the market. As a result, the employment of human labour has simply become too expensive for many enterprises. No company fighting to survive can afford to retain the dearer, more labour-intensive production methods, because it would simply price itself out of the market and thus be forced to dismiss the whole workforce. When viewed in that light, the present scale of unemployment is nothing more or less than the inevitable consequence for anyone competing against others who overdoes his prices.

I hope that my readers will note precisely the words which I use. I am speaking of the exaggerated increases in wages in comparison with capital costs. I am not speaking lightly or irresponsibly or overconfidently of excessive wage rises compared with foreign wages. I am in fact cautious in my remarks, because the following situation may well arise. If the word spreads round the world that we have particularly well disciplined trade unions in West Germany with modest wage demands (and the foreign exchange markets are characterized by their tendency to anticipate future conditions more than any other market), then it may well happen that this very discipline practised by the trade unions under the system of flexible exchange rates will be overcompensated by an excessive revaluation of the deutschmark with a resultant decrease in competitiveness. And all because of our unions' discipline!

The reverse case is equally explicit. If we start to pursue a completely unrestrained policy on wages marked by very high wage increases – and that was certainly not so in the recent round of wage bargaining – or if we take the case of another country where such conditions prevail – then it is quite possible that that country will again become competitive because the subsequent rate of devaluation outstrips the rate of wage increases.

I have added this point solely to demonstrate that I do not belong to those who endeavour to add to the list of arguments (and thereby no doubt fostering unemployment) the comparison between domestic and foreign costs. But a factor which I certainly do adduce and which I call my main argument No. 2 is the ratio between labour and capital costs.

At this point, the following should be borne in mind. If the recent collective wage agreements in some branches of trade and industry on guaranteeing wage levels despite the opportunities for economy measures under rationalization schemes find adherents and start to spread, then that would certainly exercise a second boomerang impact. Indeed, I am surprised that neither the politicians nor the journalists have drawn attention to this point.

Just think for a moment of the consequences if this practice were to become universal! Both domestic and foreign entrepreneurs would set up new firms everywhere without the whole burden of the type of safeguard to which I have just referred. These new enterprises would purchase the latest machinery. Let us take the example of a printing works. It would take on staff to operate the latest machines. And these new competitors would spoil the sales opportunities of the old enterprises burdened with guaranteed safeguards to such an extent that the only claims remaining from the arduously negotiated guarantees would be the claims against the modest bankruptcy estates of the old German firms!

Markets tend to react very quickly to such a situation. As I recognize so many people sitting here whom I used to meet in the corridors of the Ministry of Economics over a generation ago, I feel emboldened to enquire whether any of you used to work in the old bizonal «Economic Administration for the American and British Zones of Occupation.» I have to think back to those times as I stand here, and I recall that in those days we had to fix quotas for the import of red wine. One of the officials decided to ration every wine importer to ten hectolitres, hoping that this would get rid of the problem once and for all. But the outcome was astounding. The number of traders registered as wine importers increased tenfold within eight weeks.

The course of events will probably not be quite so rapid as that after the strains of guaranteed claims, but the principle will be similar. If entrepreneurs start setting up new firms to avoid these troubles, then I feel certain that the Government will come along with a fresh set of regulations designed to cover these establishments. In this context, it is interesting to recollect the experience we gained during the attempts made by companies to avoid being affected by the provisions of the Co-management Law. But enough said about the relationship between wage costs and capital costs!

The trends up to the year 1972, when German workers reached the highest incomes in the world in real value and made «unemployment» virtually an unheard-of thing, go to show that all workers and the currently unemployed in particular are better served in real terms by a renunciation of excessive nominal wages out of line with the market.

Let us recapitulate factor No. 2. Wage costs per unit of production have increased more sharply than the cost of substitutive capital – with the best of social intentions, but again with pernicious social consequences.

Financing Social Benefits

The third factor consists in the practice of directly burdening every single firm which also employs the needy and disadvantaged in society with the cost of all social-welfare measures instead of these being financed from general monetary contributions or taxes.

The parliamentarians among you will remember that the question of continued wage payments in the event of illness gave rise to a dispute about whether to base the final solution on insurance provisions or labour laws. The former solution is more compatible with our fundamental principles because it can then be built into the arrangements for a fiscal adjustment among the various social groups, which *Müller-Armack* deemed the basis of all social policy. By contrast, an arrangement under labour legislation constitutes serious interference with the interplay taking place between the factor prices. And what decision was finally reached? In favour of the latter! This meant that the authorities had moved completely out of line with the market by excessively increasing the cost of engaging those persons in special need of a job (i. e. in comparison with their contribution to the firm's total output).

We can also quote the example of apprentices under this heading, not only because of the higher rate of remuneration which they receive, but also because of the financial strain of the salaries paid to the training personnel required under the new provisions. Those pupils who leave primary school without a school leaving certificate are the main group of persons

affected by this policy, because the Government felt that they deserved a special supplementary income to ease their lot.

Others affected by the new provisions are those looking for part-time jobs, persons with health impediments and elderly men and women.

In contradistinction to 1931, many of these weaker members of the community were thrown out of work and they have since remained without a job. That brings us to factor No. 3: the operating costs for employing the weaker members of society have risen more sharply than for able-bodied persons. Again, one can but repeat: the intentions were good, but not the social consequences.

Protection against Dismissal

The fourth factor consists in the augmented safeguards now provided against dismissal. When the public authorities make it difficult for firms to dismiss an employee, that enhances the risks attendant upon the appointment of new staff. It increases the price of employing someone new.

We thus once more encounter a mentality based on the belief that one can promote social welfare not by burdening the community as a whole, but by tinkering with the price structure in the wider sense of the term. Because of the augmented protection against dismissal, those managements who take the question of preserving workplaces very seriously point out that they would rather forgo thousands of hours of overtime than encumber the company with the risk of additional permanent labour costs which can virtually never be cut.

Factor No. 4 is thus the circumstance that the operating costs involved in the appointment of new staff have increased more sharply than the supplements paid for overtime.

Social Welfare Benefits and Real Income

Finally factor No. 5. For some people, the advantages inherent in the status of an unemployed person have grown more substantially than the real incomes which they would enjoy as employees. This is, of course, the special case of the optimal volume of unemployment benefit combined with the opportunities for travel, moonlighting etc. We are all acquainted with the phenomenon and I am hardly telling you anything that you do not already know.

Because of their advantages, it is very difficult to induce such persons to move to another area or to retrain for another job. Persons who remain unemployed for such reasons cannot be classified among the traditional categories of cyclical, structural or frictional unemployment. I belong to those who were forecasting as long ago as 1973 that, once unemployment benefits reach a certain level, West Germany will witness a new type of affluent unemployed. Today, that stage has been reached.

In brief, the present situation may be characterized as follows. The present type of unemployment is merely another step farther than the basically fallacious approach to social welfare. It rests on the fact that the whole spectrum of wages for work is excessive in comparison with capital costs and that, within that spectrum, the operating costs for employing the weaker members of society have risen out of line with market trends. That marks an infringement against the basic principle of a social policy within a Social Market Economy.

Furthermore, an analysis must be made of the relationship between these factors and global steering. The microeconomic components are now much more important than in 1931. At that time, wages remained virtually unchanged after the application of the first

stimulants and what we have just been describing played virtually no role at all. But we cannot apply *Keynes'* old rules for the simple reason that we no longer have constant wages.

The connection between the micro-economic components described above and the macro-economic aspects may be summarized in two sentences. However much overall demand may be increased this time in percentage terms as a result of an economic shot in the arm, the retention of a social partnership between the two sides of industry and a social welfare legislation calculated to ensure that the operating costs per employee will rise by the same high percentages every year can only mean one thing. The growing earnings out of which labour costs have to be borne will not suffice to engage even a single unemployed man or woman. Unemployment will persist. We do not have to read John Maynard Keynes to discover that: it is a matter of simple arithmetic.

On the other hand, overall demand does not need to rise particularly sharply this time. It will suffice if management, labour and government can ensure that the annual operating costs for the employment of someone only rise by slightly less than overall demand. In that case, it is clear from simple arithmetic that a pull in demand will arise for the absorption of additional staff.

It may be that certain ad hoc measures in the form of purposive employment creation programmes will prove inevitable and even advisable on the labour market in order to tide over temporary crises. But the decisive factor for the future of our economic system, particularly in our current phase, is to make sure – despite all these makeshift measures – that our economic policy continues to focus on the need for circumspect improvement and fundamental correction. In short, ad hoc measures may be necessary in certain cases, but sound methods are more important.

In order to achieve this fundamental correction, however, it is indispensable that:

1. Labour costs rise more slowly than overall demand;
2. Human labour again becomes more competitive than mechanical labour; and that
3. The community as a whole rather than individual enterprises accept responsibility for social welfare.

If this fundamental corrective proves successful, then in my view we do not face any excessive structural problems. The dilemma of finding jobs for the one to two million school leavers now entering the labour market is a modest one in comparison with the difficulty which we faced between 1947 and 1950 of integrating ten military age-groups all at once. The problem of converting production to environmental procedures is modest in comparison with the problem of adjusting an entire productive apparatus from a wartime economy to a peacetime economy. I do not accept the proposition that the present structural difficulties besetting us today are of a different magnitude to those of the period 1948 to 1956, which were mastered by a free interplay between prices without any great fuss being made.

We must never tire in the labour market of stressing the necessity of a genuine remedy for our ailments and not merely a palliative.

The way of doing that is, of course, by preserving autonomy in the negotiating of collective wage agreements. Even a private house-owner may be said to have certain social obligations vis-à-vis the community in respect of his property. And there are certain political circles in Germany who lay great emphasis on the rule that property-owners must be social-minded. We must point out the following to such people. If a private property owner is obliged to be social-minded, then such a moral duty must apply doubly to that category of persons which our Constitution entrusts with the competence for determining rules which are also binding for those not directly involved in laying down those rules. Under this heading must be included the organs of the local authorities acting within the framework of their municipal autonomy. They are all subject to the rule on bearing a special social obligation towards the community. But this also includes persons who stipulate rules pursuant to the prevailing autonomy in negotiating wage rates. In my view, they are also subject to the precept of displaying a sense of social-minded behaviour.

That implies that they must pay special attention to the probable impact of their own decisions on society in general. Moreover, they must make the expected repercussions of their decisions on the whole community one of the guidelines to their own actions.

The fundamental corrective on the labour market implies an end to the attempts to promote social welfare by sharply raising a producer's costs when he employs the weaker members of the community. Of all a producer's supply prices, why pick on that one? The struggle to achieve material improvements for the weaker groups in our modern society must not be fought in the arena for determining the level of remuneration which the individual firms have to pay. That belongs to the sphere of amending the fiscal adjustment between the various groups of the community. For if the cost of the additional benefits for disadvantaged persons is charged to the individual firms where they are employed, then we are doing these weaker members a disservice. Only if the additional benefits stem from general tax revenue, will the desired levels of social welfare be achieved.

The issue at stake is not the reduction or even the consolidation of our system of social benefits, but its complete remodelling. Moreover, such reorganization would not change by a jot the much discussed «state quota» i. e. the share of GNP accounted for by governmental expenditure and therefore ultimately borne by the private sector.

If a firm feels a social compulsion to employ apprentices even though that is no longer profitable, then it is rendering a sort of medieval soccage by making a payment in kind. In the other case, the firm pays its taxes and the special burden of training apprentices is financed from those funds. Under such a reorganization towards the pure system of a visible fiscal adjustment, the load ratio of tax burden to net domestic product becomes more transparent and measurable.

I am pleased to see that *Wolfram Engels* also ranks among the adherents of this assumption. He gave firm expression to the concept of fiscal adjustment through revenue transfers. I remember his book «Die Staatsbürgersteuer» (The Citizens' Tax, cf. *Engels, Wolfram, Mitschke, Joachim and Starkloff, Bernd: Staatsbürgersteuer*. Wiesbaden: Karl-Bräuer-Institut des Bundes der Steuerzahler, 1973). If you want to read further practicable suggestions about the ideas I have been voicing today, then I think there is no better way of doing that than to read *Engels'* book.

The need for transparency is greater than ever because of the distortions which are so prevalent today and which destroy our confidence in the whole system. If we enhance the degree of transparency via a clearer correlation to the reapportionment of revenue, that does not involve any reduction or consolidation of the social benefits or even a change in the state quota. But let us now consider the repercussions produced by the current system. Think, for example, of the occupants of inexpensive, well-built council flats who have meanwhile risen to well-paid positions but who refuse to give up their favourably priced accommodation. All the scroungers and spongers encouraged by the present system of producer subsidies or other indiscriminating hand-outs would disappear. And so we can be sure under a system of greater clarity among welfare payments etc. that the self-regulatory forces of the market generally ensure that the real burden of welfare benefits tends to decrease but that their effectiveness increases so that we finish by having better social welfare at less expense.

III. The indispensable Need for Fundamental Correctives

Let me summarize. As already indicated in the examples cited from the field of tax law to balance-sheet law, a consistent public policy must pursue fewer makeshift measures or convenient palliatives and more fundamental cures of the underlying evils.

Despite thirty years of a free market economy, we have still not yet precisely defined its social component. The correct approach under a systematic regulative policy must therefore be to terminate all the experiments for meeting social aims by introducing special prices or

special wages for needy persons. Let us end the efforts to meet social aims by granting subsidies to producers. Both of these attempts do more harm than good. Let us place the tasks of achieving social balance in their true context – in the domain of fiscal adjustment. If I confine my remarks to our domestic economy and leave aside the major worldwide tasks, then I see the remodelling of our system of social balance as the main current task in regulative policy for safeguarding the Social Market Economy.

The first objection likely to emerge is this: how can such measures be implemented in political terms?

Well, my reply would be as follows. Quite recently, the «Königswinter Talks» took place – this time in Oxford. In the working group on unemployment, I spent many hours listening to Britons and Germans voicing the old arguments and sentiments: the persistent weakness of growth, underlying structural problems, the reorganization of total working hours i. e. more holidays or earlier retirement. The arguments which you can hear in our country every day were trotted out time and time again. But then a charming lady took the floor with the following observations. «What you have just said, gentlemen, may be perfectly all right and true, but we must nevertheless frankly admit that we have committed political errors. It is no wonder that we have so many young people who are unemployed because of all our demands on employers in regard to training and remuneration. The essential point is that we have made it unattractive to hire young people. We must alter this, we must again make it more attractive for entrepreneurs to hire young people.» And who was this attractive speaker? *Shirley Williams*, the Secretary of State for Education in the Labour Government.

These times of crisis seem to have their good side, too, when even a Minister of Education of the United Kingdom (in a Labour Government!) calls for greater attention to the basic rules of market-economy regulation. That gives me cause for hope.

Section II

Transfer Incomes

Political and Ethical Aspects of Social Policy

Leopold von Wiese

1910

Despite the intrinsic qualities which render them apposite for certain relationships in social life, the three precepts of charity, humanity and patriarchalism cannot be recognized as the ruling ethical principles of the present age. The true social ethos, which is emerging with ever-growing clarity as the main moral theme of the twentieth century, differs from the three aforesaid principles in the following way. It does not break up the connections between rich and poor, educated and uneducated, mighty and subordinate into numerous individual relationships, but attempts to comprehend individual men and women within the context of their social class. At the same time, it views relations between the classes as a major and intractable problem of claims and deems the services and sacrifices for the less fortunate or less powerful sections of the population no longer as acts of charity and as benefaction but as deeds of compensatory justice. Although social differences and inequalities are accordingly considered to be indispensable and ineradicable – despite the opinions advocated by radical communists – they do nevertheless appear to be capable of displacement and mitigation in socio-ethnic terms. The advantages and prerogatives enjoyed by the upper class are not seen as a God-given high status accorded to the chosen few by virtue of their natural merits, but as a social expediency invested with a claim to retention only so long as the overall population clearly prospers more when such distinctions are drawn. Property is not held to be a reward for meritorious service as that deadly enemy of social ethics, Arrogance, would have us believe. Similarly, educational distinction and personal talent and other accomplishments are considered to be individual attributes which primarily enjoin upon their possessors the duty to put them to use on behalf of the whole nation.

All socio-ethical acts are inspired by the thought that each individual goal in life is linked to the fate of the country as a whole and that all groups of the population must be helped to attain a secure fundament for a dignified existence. The propertied classes do not possess any independent, imperishable rights: they must make sacrifices without regarding them as sacrifices. The economically disadvantaged classes may receive «benefactions» without enthusing with gratitude.

Finally, the culminating point in social ethics is the belief that the poorer, powerless classes of the nation as a whole (and not just some of their individual members) can enhance their rights, their property and their level of education by dint of self-help, public welfare and governmental assistance.

The true domain of social ethics lies in public welfare and we intend in this essay to set forth its cardinal principles. Where social policy has an ethical content, the same spirit described above also prevails in it – only that, in this case, it is constrained by political considerations. The fact that this separation between the principle of public welfare and the central precepts of social policy does not amount to a sophism or an extenuation of the harder nature of social policy, but to an objective necessity and that consideration for its political content caused by the pattern of power distribution compels such separation also emerges convincingly from a number of other factors.

All measures of social policy such as protective labour legislation or workers' insurance, which cover hundreds of thousands or millions of people, can by their very nature only be implemented in mechanical fashion. There will be an opportunity at a later stage to speak of the shortcomings and drawbacks of these over-generalized laws and ordinances. Behind all social welfare directives loom police supervision, constraints and penal provisions. Personal and individual traits disappear entirely. Whereas the higher status assigned in social ethics to the fate of a class vis-à-vis the fate of an individual has marked a certain step forward compared with former principles, such a gain actually becomes a partially necessary, albeit unwelcome hardship in social policy. In the realm of social policy, there only exist masses – and no individuals. The individual becomes a mere cipher, he disappears totally in his class. The infinitely profound differences between one person and another exercise nearly no influence on social policy. Indeed, social policy is concerned with mass phenomena. Among all the socio-political provisions which exist today, there are many whose origin lies in social goodwill but which are now almost considered by their very nature to be injunctions or even painful constraints. Such provisions make no allowance for the nuances peculiar to all human distress or for the fact that extraneous harmful influences, more or less curable by socio-political measures, often combine with personal factors and emotional distress to become a real hardship. In numerous instances, the distressed person attaches much greater significance to kind words and simple friendliness than to bureaucratic relief measures. I shall have more to say later on the serious defects of all social policy, its innate sterility and its reliance on supervisory agencies for implementation. I would only like to stress at this point that the importance of a conceptually distinct field of «public welfare» lies especially in its capacity for greater individuality than social policy. Please do not misunderstand me: in a different sense than that used here, a policy of public welfare enjoys the advantage that it is more socialistic than charity and humanity. The benefits conferred by socialism lie in its relieving a distressed individual of the responsibilities with which he was unintentionally encumbered by ignorance under the older systems. Under the present relationship between modern public welfare and our current social policy, we regard the advantage of a policy of public welfare as consisting in its more modest measure of socialism inasmuch as personal fortunes and needs can attract greater attention than in social policy. Moreover, there is no need for the spirit of the civil service and of the police force to prevail so that the baneful rule of the letter rather than the spirit can be avoided. There is no need to treat all alike: there is scope for the individualizing breath of love, whose value in social life marked the beginning and the prerequisite of this study. One necessary element in any understanding of the many implications of this subject is to understand the progress made from the older type of individualism to modern socialism without thereby forgetting the disagreeable side-effects of «general socialism». I trust that it will not be deemed a contradiction if we support *Adolf Weber* from the standpoint of social ethics in respect of his observation that social assistance is good, but individual help is better.

This analysis of the connection between politics and ethics as well as of the nature of public

welfare is necessary in order to compare the external (and more specific) significance of social policy with its internal (and more general) significance. Only those who recognize the original and varied links in social policy between two originally and intrinsically hostile elements – politics and ethics – will obtain a clear insight into the nature of this sphere. Furthermore, such persons will avoid many obscurities and blunders if they regard public welfare as the field of action for non-political social ethics i. e. adjacent to social policy and linked to it by common features, yet by no means synonymous with it. By way of summary of the inquiries set out above, we can now say a few words about a working definition of social policy. If general politics signifies the utilization of people's services (and extension of territories) or the averting of such efforts whereas specifically national politics is intended to create a balance (a legal order) in this struggle between people and groups of people for power by means of priorities and subordination, the subject of general social policy may be described as the struggle between the social classes for power and that of special national social policy as the State's activities in regard to these social classes (based on differences in property, education and occupation). The ethical aspect of social policy is reflected in firm adherence to the unqualified application of justice as the yardstick for assessing sociopolitical facts and ideas. And we could add the following. To the extent that social issues are problems of the whole economy (i. e. problems involved in the systematic satisfaction of external wants by an expedient organization of social groups), they are based on the following fundamental question: how can economic organization be shaped in such a way as to accord not only with the basic economic principle (i. e. the aspiration to maximum benefits with minimum expenditure), but also equally with the socio-ethical precept of justice and in particular with the need to promote the economically less privileged members of the community.

Naturally, such a definition is intentionally cast in broad terms in order to cover the wide-ranging opportunities which must be taken into account for every kind of social activity. The definition must primarily provide scope for the two tendencies which we are always encountering in applied social policy: the measures designed to assist certain classes of society, in particular those dependent on their wages such as factory workers, agricultural labourers, home-workers, female workers, office employees, messengers and junior officials. The chief function of social policy in this field consists in reestablishing the communal links between the social classes which threaten to become looser and looser. We should further bear in mind that, in principle, every class of society may become the object of social policy just as every epoch of history has experienced its sociopolitical schemes. Even the ancien régime, which did not have a developed class of industrial workers, found itself compelled to pursue a social policy towards its burghers and peasants.

The second of the two aspects of social policy to which I referred comprises all those measures adopted in the social struggle and especially all the endeavours undertaken by the State to curb and restrain certain classes, whose claims and attitudes appear to constitute a danger to the whole nation. The history of social democracy or of anarchism and above all the attitude of the State to these social movements forms a major component of social policy in that no coherent and exhaustive account of the development of modern self-help through systematic organization or of the State's protection for workmen can be provided unless the historic vicissitudes in the relationship between the State and social democracy have been carefully studied.

The Foundations and Limits of Social Policy

Adolf Weber

1930

[. . .] «Social policy is the embodiment of the measures and facilities designed in the interest of society to promote the community, personal freedom and the dignity of working people and to bring about a sustained improvement in their incorporation within the goods and services sector of the economy». This seems at any rate to be the current aim of social policy and also the aim of those who aspire to a new social and economic system. Let us then proceed from this line of approach and consider with as much impartiality as possible whether such an aim is feasible and, if so, how we can accomplish it. However, certain definitions of the terms used are necessary in order to obviate misunderstandings. According to *Zwiedineck*, social policy is a «policy directed towards safeguarding the continuous attainment of society's aims». There thus devolves upon society a duty to preserve itself: anything which militates against maintaining the substance of society cannot be social policy. When the Bavarian Soviet Republic had reached the pinnacle of its power, *Gustav Landauer* issued the following ministerial decree: «Everyone shall work as he deems appropriate and every position of subordination is hereby annulled. Juridical philosophy is now a thing of the past». Perhaps this Communist believed that only then could the fundament for a genuine social policy be said to exist. But if doubts remain as to whether juridical philosophy is really indispensable for the continued existence of society, all mankind's experience to date points to the indubitable necessity of super – and subordination. Any policy militating against such exigencies cannot fail to bring about the downfall of society: it is anti-social in the true sense of the word. The object of social policy cannot consist in the attainment of a single class or the furtherance of those people classified as «needy». The object of this policy is to assist the guardians of society, that is the whole corpus of workpeople including those who are preparing themselves physically and mentally for work as well as invalids in the widest sense of the term. Working people are all those who place their human skills at the service of society: intellectuals and labourers, entrepreneurs and their employees, craftsmen and farmers, merchants etc. All these men and women have

to rely on each other. Everyone of them is without significance except in relation to the others. These people join hands together to enhance the prosperity of the nation. But the prosperity of the nation is identical with the sustained enhancement of the prosperity of the national economy. Those who subscribe to this sociopolitical goal can only acknowledge a right to interest, profit and rent inasmuch as these categories of income are necessary for achieving the social objective in general and effectively raising the prosperity of the national economy. Admittedly, the important thing is the lasting nature of the increase. Those desirous of attaining momentary success without thinking of the permanent consequences, those who endanger sober-minded and steady application by diverting the labour of the people into the service of unfulfillable illusions, those who bang their heads against the wall instead of putting them to good use and constructing with patience and composure instead of destroying – all those who think and act in this way are contravening the basic principles of social progress. Their mode of thought is not social; it is anti-social.

The question as to how incorporation into the goods and services sector can be improved for work-people as a whole is the most crucial socio-political issue for the professional economist. The discussion of this problem has become much more fruitful at the present time as a result of the abandonment by everyone seriously interested in social policy and its further progress of a widespread prejudice, which had also found its way into an erroneous doctrine. Even the brightest of Germany's armchair socialists, *Adolf Wagner*, saw social policy simply as such governmental policy «as attempts to combat abuses in the distribution of national assets by legislative and administrative means». The conviction prevailed that poor people could become richer if one made the rich people poorer. This creed was found to be a fallacy. All theorists including even the Marxists concede the impossibility of increasing the share of wages at the expense of the share of capital. The possibility can in fact be completely ruled out from the beginning in the case of an economy like the German economy, suffering as it does from a lack of capital resources. At the ceremony to celebrate the tenth anniversary of the Ministry of Labour, the minister himself – *Herr Wissell*, a socialist – declared that the workers' share of the GNP could only rise if the national income itself rose! This expressed the virtually unanimous view of Germany's theorists and practitioners of social policy. That is clearly perceptible despite occasional relapses into primitive theories about the distribution of the national product. Such a relapse takes place, for instance, when the thesis crops up that the capitalists must tolerate wage increases as a premium for the «pacification of social life». Inasmuch as such a premium is really paid, the workers have to pay it out of their own pockets!

We hardly need to be told that any increase in the national product turns upon ability rather than upon volition. In our attempt to satisfy mankind's requirements, we shall find in the realm of economic exigencies only a few «free zones» where the will to mould the economy is able to prevail. The mission of economists enlisted in the service of social policy consists in detecting these free zones and demonstrating how an extension could perhaps be carried out. Another object is to point out that any transcending of the limits of these free zones will be punished by an appropriate advance of the bounds of economic exigencies. There have been times in the past when socio-political volition has lagged behind capability. This was the case when the Association for Social Policy came into being. On the other hand, there may be times when sociopolitical wishes fail to discern socio-economic necessities and in this way endanger socio-political achievements, which have in fact long since been secure. The decisive question in this case is: how much can we rescue of the old social policy and in what way can we rescue it. Those who voice a warning about socio-political measures in such circumstances are, in reality, the true friends of a sound social policy. Politics are the art of doing what is possible; and that also applies to social policy.

The economic free zones become all the more extensive and assured, the more frequently that capital becomes available for economic use. The two production factors, land and labour, are today firmly circumscribed as a rule. The only production factor which man can

shape through his conduct is capital. The greater the volume of permanently available capital, the larger the opportunities for a promising social policy . . .

Where wages are raised at the expense of capital formation in the economic sense of the term, we can then speak of an excessive increase in wages. This in turn will tend to foster a decline in the national economy and in social policy. The external manifestation of this will be chronic unemployment . . .

The true significance of a general increase in wages and salaries becomes clear when we recall that no less than 90% of the goods provided in the economy stems from labour performances (including the services of public officials). Needless to say, this involves not only direct labour performances but also indirect ones such as those embodied in machines and in the procurement of raw materials. As a result, a comparatively small but general excessive increase in wages can gravely impair the formation of capital and thus also the demand for labour. Clearly, those who lose their jobs can be found employment or supported for social and political reasons out of funds compulsorily withdrawn in the form of taxes from the economy. However, these are then found to be lacking in the formation of capital. But in reality, that is refusal to face facts and this can only delay and aggravate the cure. This situation resembles that of inflation. The restoration to health can be delayed and the patient may feel quite well for a time. But we know only too well from experience that the end will be all the more bitter, the longer one hesitates to tackle the evil at its roots. Excessive rises in wages also share a common feature with inflation and any other serious ailment in the economic organism in that, when danger looms ahead, the easy power of control over capital means that it can be readily withdrawn from the perilous zone and transferred elsewhere – even when drastic steps are taken to prevent this. In consequence, the position of the workers worsens in the direction of a catastrophe with ever greater rapidity.

Once that capital formation and thus the national economy itself begin to be jeopardized by excessive wage rises – and this juncture cannot be pinpointed with the precision applicable to inflation in terms of the exchange rate and the price index – then everything must be done in order to tap the natural healing powers inherent in the economy. But the best natural cure consists in an elastic price, accommodating to the degree of scarcity – the price ruling on the market for finished goods and the price ruling on the market for producer goods. It would be wrong to attempt to overcome the fatal excessive increases in wages by raising wages uniformly by 10% or 15%. It is more important than ever to replace a wage decreed by the central authorities by a wage adjusted as much as possible to the actual performance for the economy.

Mistakes in the economy have the unfortunate habit of being perpetrated in haste but of proving to be amenable to a slow and gradual remedy only.

[. . .] A country's economy does not constitute an end in itself: its purpose is to serve mankind. People make greater demands than the mere satisfaction of material needs. In our times, they call with growing emphasis for consideration to be given – also within the framework of economic life – to the ideals of the community, to freedom and to the dignity of work-people. I need hardly add that this trinity is continuously put at hazard in the struggle for one's daily bread and for what is mine or thine in the economy. As long as man remains man and his infinite needs are matched by a scarcity of the means of satisfying those needs, this will always remain so. The only important thing is whether the special features of the existing economic order and its development involve special dangers for the community, its freedom and the dignity of man.

Inasmuch as our aim consists in the maintenance and promotion of the community of working people i. e. their awareness of a sense of mutual identity despite all individual and group differences, I deny that very categorically. Indeed, nothing can arouse the communal spirit and personal identity with the community as much as learning to understand and appreciate the importance for the economic and social advancement of everyone of smoothly integrating the millions of working people into the economy. These form the real and truly

strong roots of the communal spirit, unlike the artificial theories with which the apostles of some mysterious holistic philosophy wish to delight the world. It is not true to allege that a worker's wage interests must be diametrically opposed to a capitalist's profit interests. Quite the reverse! A profit interest held in check by the force of competition has proved to be the best pioneer for the economic progress made by all employed men and women, including of course the wage-earners proper. *Carl Landauer*, who made no secret of his socialist leanings or his adherence to the class-warfare doctrine, had to admit in the last edition of «*Soziale Praxis*» that reforms under the capitalist economic system coordinate the true interests of the workers with those of the entrepreneurs on a much wider scale than the former are aware of. If a communal spirit cannot really evolve among working people, that is not due to the special nature of the economic system in which and for which they produce their wares, but to the workers themselves and to the manner in which the class-warfare doctrine has been abused in order to foment hate in the working community. It flows from the immense rapacity of those who view the economy not as a means to an end, but as an end in itself. It flows from the conceit of those who still fail to grasp that, in a modern economy, everyone is dependent on the others. We are all participants in the same undertaking, whether as brain-workers or manual workers, as craftsmen or office employees, managers or entrepreneurs. In such a working community, there exist super- and subordination; but there are no rulers giving commands to serfs. It must also be admitted that today there are still more employers and employees in Germany than in other capitalist countries who are «tainted with resentment derived from the fate suffered by former generations» (*Adolf Lampe*).

At the outset of the capitalist economic system, individual freedom and dignity seemed to be at frightful risk. The expectations that the doctrine of *laissez faire* – *laissez aller* would by itself lead man to new freedom and new dignity were profoundly disappointed. *Adam Müller* spoke of the «duplicity of a specious freedom bestowed upon mankind by liberalism». And there is no more distressing affirmation of this judgment than the content of the «blue books» which *Karl Marx* studied in England and which provided the foundations for his economic theory. But if we follow developments back into history, then every impartial observer will have to admit that never before has such rapid and profound progress been attained in making work more democratic than that under the capitalist system.

The evolution of the capitalist economy signified an ever accelerating advance of what is functionally necessary at the expense of the influence of personal power without, however, eliminating the significance of individual initiative. The grandseigneur of feudal times could safely order his vassals to slave for him in the knowledge that his descendants would be able to afford the same *dolce far niente* if the system continued. Nowadays, a captain of industry is bound by economic exigencies. Day and night, there looms behind him the *atra cura* that capitalist methods destroy fortunes and make men into servants if somebody proves able somewhere else to introduce better and cheaper production methods. Economic power has long since been detached from personal wealth. The remark ascribed to a well-known tycoon – «the firm means everything, the shareholders nothing» – may not be the acme of economic wisdom, but it nevertheless furnishes quite a good idea of the changes which have occurred since the early days of capitalism. Trade and industry have created for themselves organizations which are not tied to the fortuitous circumstances of someone's personal fortunes. As soon as workers have grasped the purpose and the essence of commercial management in the capitalist economic system, they will hardly have any special wish to participate directly in such administration. They have the keenest interest in ensuring that the responsibility of capitalist entrepreneurs is not diminished. They should also realize that the socioeconomic laws create all the more opportunities for implementing the goals of social policy, the fewer attempts are made to dictate the latter from outside.

The propertied class and the managerial class have undoubtedly forfeited some of their freedom of choice. They forfeited it so that those who carry out the work could enjoy more freedom.

The freedom of working people as consumers has become so great that sincere lovers of our country like *Walter Rathenau* have asked in a mood of solicitude whether this measure of freedom has not now become too great. Be that as it may, there is no denying that even the greater freedom of consumption open to the broad masses of working people has substantially helped them to shape their lives in accordance with their own scale of values. Let us also appreciate in full the gratifying socio-political advances we have been able to procure for the wage-earners in the course of past generations: the legislation to protect labour, the reduction in working hours and in particular the social insurance provisions. Let us also bear in mind that the trade unions wield power not only because of their large membership, but also because of their income and assets now worth hundreds of millions. The economy has only been able to provide all of this thanks to the progress made – progress based on a competitive economy and on private property. This same progress has made it possible for more and more people, keen to get ahead in life, to become the architects of their own future. More and more people have been able to shape their own destiny on the basis of their skills and their wishes. And another point of considerable importance. The more that economic growth proceeded apace and the more that capital was made available for trade and industry, the higher became the wages of skilled workers and the greater the importance of refraining from regarding people simply as muscular machines and of starting to treat them as intelligent beings enlisted in the service of humanity. At the same time, the rising significance of fixed capital with the implications for its holders to put it to expeditious and continuous use or else risk grievous losses forced entrepreneurs to take into consideration the wishes of their workers (despite their statutory guarantees of a minimum income) just as much as vice versa.

Freedom and dignity are subjective things. Fortunately, no official decrees are issued under our economic system as to what the individual must accept as freedom or dignity or personal happiness. If we are to accept some of the utterances of socialist theorists at their face value, then the supreme condition for a feeling of freedom and dignity is as short a working day and as high a wage as possible. If that view is correct, its advocates must feel a deep sense of shame that one of the most significant activities in our national economy, i. e. that of the small-scale farmer, attracts a more modest level of remuneration and entails a longer day's work than those of the youngest of unskilled industrial workmen. These advocates should in fact step forward in the name of poetic justice with a demand that the wages of other labourers should be cut in the interest of rural workers' pay. On the other hand, one can perhaps entertain quite a different view of material happiness in an economic system inspired by private ownership of the means of production: namely, the idea that one intends to bequeath to one's children the property inherited from one's parents and grandparents as the basis for independent work – however formidable the latter may turn out to be.

For this reason alone, it can be said that those who propagate militant opposition to the private ownership of the means of production in the name of freedom and dignity are guilty of wrongful conduct. Moreover, such persons also contradict the enlightened self-interests of industrial workmen. The struggle to end private ownership of the means of production is also a blow against the freedom and dignity of the workers, too. That brings us to our present situation, where we stand poised to introduce new facilities under our social welfare legislation which certainly do not elevate the dignity and freedom of working men. The new sick-certificates entitling workmen to free medical treatment are not an attractive innovation of social policy; but we have nevertheless to incorporate such facilities into our system. Indeed, it is my fear that we shall have to incorporate them on a growing scale in the immediate future, because our funds will not suffice to permit social legislation to operate as freely as we would like. The cruellest affront to human dignity is to be thrown out of work. The president of the Christian Association of Metal Workers was echoing the sentiments of all of us when he said that «it is a thousand times more appropriate to the spirit of trade

unionism when we do our utmost to thin the ranks of the jobless than it would be to add a few pence more to the hourly wage rates of those with safe jobs. Past experience has taught us that the volume of unemployment becomes all the smaller, the better the adjustment processes peculiar to the capitalist economy are able to develop.

When we look back through history, we find that the greatest progress ever made towards liberating the common man took place hand in hand with the free ownership of land and capital. By the same token, the speediest and direst relapse into bondage occurred in Bolshevik Russia when the free ownership of the means of production came to an end. But it would be an injustice to the Bolsheviks to ascribe this result to a lack of good will or to insufficient understanding for human dignity and freedom. It was simply the outcome of a decline in productivity consequent upon the abjuration of a competitive economy accompanied by the equivalent increase in personal constraints required to secure a livelihood.

In my opinion, this line of approach also brings us to the same conclusion. A sound social policy requires a sound national economy and a sound national economy is inconceivable if individual interest in gainful activity wedded to a sense of self-responsibility and self-initiative cannot develop or if there is no opportunity for individual members and groups of society to coordinate with each other in the manner furnished by an elastic capitalist market. If this system is in jeopardy, then all forces must be mobilized in order to save it. Those who prefer to entice away the rescue party so that it can join in the fray at a new building-site, for example, are acting contrary to the interests of the community of working people. After all, working people are not merely the executants of the capitalist economic system, they are also its beneficiaries.

A Financial Policy Designed for Social Balance

Kurt Schmidt

1957

Today, social balance is not only a political demand (and one which has partly been translated into reality), it also mirrors to a considerable degree the economic and social currents of contemporary thought. There is, then, no need to waste any time on the topicality of an inquiry into this problem. Moreover, the central importance assigned to the goal of social balance renders it easy to see why the instruments of financial policy have also been enlisted in its service. Indeed, financial policy has acquired a particularly significant role to play under the social market economy, because it was felt that it only exercises an indirect and thus a less disruptive influence on the formation of prices.

The socio-political mandate for the makers of finance policy is to redistribute the income and wealth derived, or still being derived, from market processes. There are two types or rather two directions of redistribution – a vertical and a horizontal one. The vertical reapportionment consists in «the transfer of purchasing power from the sections of the population with a substantial income and/or wealth to those with a modest income and/or wealth» (*Jeckel*). This constitutes the aim of classical social policy: to reduce the differences in income and wealth.

I

What possibilities exist for financial policy-makers to achieve the desired social balance? Let us begin our inquiry with a look at public expenditure on social welfare benefits. Whenever the re-allocation process via the market does not ensure a minimum living standard to all members of the community, public authorities must intervene not only for humanitarian but also for economic reasons, because «pauperism» represents a danger to the normal running of the market» (*Colm*). As experience has taught us, the public authorities' volume of activities has steadily increased both qualitatively and quantitatively – in

particular as regards social welfare. Among the «new» social tasks, mention may be made of a free health service, retirement pensions and free education. These public benefits accrue to private households in various forms. On the one hand, families may be paid direct sums of money, these being earmarked either for free use or for specific outlay. Another method is for the authorities to grant indirect subsidies by financing the price of consumer goods. Finally, the Government may choose to provide the benefits in question free of charge by bearing their costs itself and exempting private households.

If it is to defray the expense of public welfare, the State must of course obtain the requisite revenue. Unless the Government is prepared to jeopardize the stability of the currency, the main approach to the procurement of these funds will be via taxes. There is hardly any need to elaborate on the point that taxation *ceteris paribus* will be all the sharper and heavier, the greater the financial needs due to mounting social benefits. Moreover, the recipients of benefits under expensive social projects must largely raise the required funds themselves. Even relatively steep and wide-ranging scales of progressive taxation on income will fail to rectify the situation if the volume of transfers is substantial, because there remains no wealthy minority to bear the brunt of the «costs». As more and more individual burdens are borne by the State, the redistribution of incomes will switch from the vertical to the horizontal i. e. reallocation will proceed less from high-income to low-income groups of the population but take place rather within the low and middle-grade incomes.

That brings me to financial measures available to Government for accomplishing a better social balance by means of receipts and, in particular, of taxes. *Adolf Wagner* once noted: «taxes in the socio-political sense of the term are those levies and imposts serving the purpose of regulating and changing the distribution of national income and wealth which has accrued, or is accruing, under a country's economic and legal system».

A vertical equalization of income and wealth may be achieved by various fiscal means. «One of the first opportunities for realizing this goal consists in provide for the tax system with a more social character; and this can be effectively carried out by shifting the main emphasis from indirect to direct taxes» (*Neumark*). The result of this step is to reduce the regressive impact, i. e. the burden of indirect tax which decreases in percentage terms as income rises. But in view of the substantial financial requirements (caused partly by high social benefits) and the current burden of direct taxes, the scope of this possibility should not be overestimated. In order to avoid a steadily decreasing incidence of tax on incomes, it is all the more important to introduce progressive scales for income tax – directly through rising tax rates and/or indirectly through the granting of tax-free allowances. If the public authorities succeed by this means in attaining a proportionate incidence of tax on incomes, then one speaks of a «compensatory progression». However, that only holds true when certain assumptions are made in regard to passing on taxes. As a matter of fact, we know comparatively little about these operations. When sellers' markets prevail, more taxes are passed on than in times of buyers' markets. It is also probably that «direct taxes are passed on to a relatively smaller degree and indirect taxes to a relatively larger degree» (*Jecht*).

The goal of a tax levy in line with social policy lies more distant than merely as far as up to the proportional total tax burden. In this case, the payment of taxes would not alter the material circumstances of tax-payers; and a social balance would be achieved only if the «overburdening of the lower income groups» (*Gerloff*) were ended which is the result of indirect taxation. Such vertical redistribution can only come about via an absolute progression i. e. a progressive overall incidence of taxes on income and wealth. One of the characteristic features of this type of progressive tax scale consists in levelling off the peak of the income- and wealth pyramid.

But that is only one side of social balance. Our next question must be: to what extent can the funds obtained from progressive taxation serve to «complement» modest incomes and assets? This entails difficulties in that the demand for vertical equalization in income and wealth is quantitatively indeterminate. The real goal to be seriously pursued is not equality,

but more equality (*Hayek*). Yet however we may interpret this call for a more even distribution of income and wealth, the reality dividing volition from action lies in the scale of fiscal means available under a reallocative policy. These means are comparatively limited. That also remains valid if the Government redistributes all income and wealth over and above a certain amount. If redistribution is confined to those funds emanating from an absolute progression in the taxing of income and inheritance, then the available volume of transfer payments declines in accordance with the agreed scale. Hence, a vertical redistribution of funds from tax progression hardly possesses much significance as a means of equalizing income and wealth among the population due to their modest size. As shown above, it is therefore all the more important to be in a position to level off the peaks of income and wealth taxation by means of absolutely progressive scales of tax.

II

1. What is the effect of the financial measures designed to secure social balance? Let us again begin with public expenditure on social benefits. As already indicated, this has become indispensable to a certain extent, namely to safeguard a minimum living standard for everyone. Even so, it is impossible to define explicitly what constitutes an adequate income. It will vary in accordance with place and time and rise in line with an expanding national income. Hence, there remains a certain scope for manoeuvre in assessing what amounts to a minimum living standard. Be that as it may, the assessment must not seem too liberal, lest the resultant «pensioner mentality» weaken the will to look after oneself! But as long as such public assistance continues at a modest level and is available only in cases of emergency and unforeseeable situations such as war, these disagreeable side-effects are either unlikely or exist on such a small scale as to bear no relationship to the positive effect of this measure.

The more that public assistance expands, the more probable it becomes that the negative side-effects will increase and offset, or even eliminate, the positive impact of redistribution. *Jecht* once observed that the «intensity and scale of the working efficiency may be reduced if pensions and support are not reasonably related to the income of wage-earners».

A further factor is the tendency for horizontal redistribution to replace vertical redistribution as the outlay on social benefits rises. This bears in two ways upon the savings of private households which only draw a modest or medium-sized income. On the one hand, a rising level of public welfare discourages the propensity to self-help, i. e. to private savings; whilst on the other hand, the opportunities for so doing decrease due to the growing social burdens to be financed by every family.

This not only affects an important source of capital formation for the national economy, but may also widen differences in levels of personal wealth. If the investment requirements needed for a certain growth in the G. N. P. are still to be met in full, private savings must be replaced by other forms of capital formation. This tendency is aggravated because – as we shall see – the capacity of the recipients of larger incomes to save dwindles as a result of the progressive tax scales intended to promote the Government's social policy. The gap in savings by private households can be closed by the self-financing of business enterprises or the formation of public capital. The first case entails a shift in assets in favour of the owners of material means of production. As it becomes more difficult for non-owners to save under a financial policy designed to promote social welfare, the differences in personal wealth widen! The way to curb this trend is to introduce progressive scales for wealth itself or for the State to form capital resources. I shall revert later to the first possibility. As regards the formation of public wealth, it should be noted that this remains relevant to a modern regulative policy. The reason is not only because the volume of public property is increasing, but also because productive capital thereby passes into the hands of the public authorities, thus restricting private business management.

2. What are the consequences of a socially-motivated progression in income taxes and death duties? Before analyzing these effects, it would be expedient to take a look at the motives underlying human behaviour in regard to earning money and saving. As *Gerloff* has observed: «in his economic behaviour, man does not act solely in accordance with utilitarian considerations . . . and, in his social environment, he is much more of a *homo ambitiosus* than a *homo oeconomicus*. In other words, the conduct of someone engaged in an economic activity is not governed exclusively by economic calculations but also by the «status competition between the members of a society for distinction» (*Hofstätter*) and for a firm place in the race for income and wealth. For the sake of simplicity, I shall speak in the rest of my article of the «profit motive» when human behaviour rests on economic calculations and of the «status motive» when it depends on the significance of income and wealth for «social standing». It should also be borne in mind that private savings are influenced by the quest for security.

The acquisition of income and wealth is primarily governed by three factors: human labour, entrepreneurial willingness to undertake risks (decisive for the size of fresh investment) and private capital formation. These three circumstances also constitute the direct components of economic growth, and an increase in G. N. P. depends on them expanding. Thus, a study of the impact of progressive scales in income tax and death duties upon these three factors also helps us to determine the major consequences of progressive taxes for economic growth.

(a) What effect does a socially oriented income-tax progression exercise on the enhancement of labour performance? The reply to this is clearly negative from the standpoint of the profit motive. A decision on any increase in performance depends on the (subjectively evaluated) relationship between increase in effort and growth in net income. However, one feature central to progressive tax scales is that the tax burden grows with every additional unit of income. As a result, tax progression is inimical to any increase in labour performance and this tendency increases as incomes grow. But that in turn affects qualified work, which is comparatively well paid and which possesses first-rank importance for economic growth.

Is this outcome modified if we take the «status motive» into account? If we proceed from a person's gross income as his principal status symbol, then the striving for a higher rank involved in the differentiation between gross incomes is not affected by progressive scales of tax. If we consider only the status symbol, then the increase in human effort is not impaired by virtue of tax progression. Yet this result must be modified substantially when we take into account consumption standards and property as status symbols. In that case, the disposable income is decisive – and its growth steadily decreases despite a rising gross income due to the operation of progressive taxation. In that case, taxpayers will no longer endeavour to increase their gross income, but try in some other way to augment their after-tax income. Among the indirect consequences of «overtaxation», mention may be made of illicit work, the covering of private expenditure by tax-free subsidies, payment of expense allowances, declaration of private spending as entrepreneurial or public expenditure etc. If we leave aside for the moment the political and ethical problems inherent in the methods of tax evasion, it is highly disquieting from the standpoint of a sound redistribution of assets that these opportunities for increasing disposable income are available to the various taxpayers to very different degrees. In addition, it seems highly doubtful whether all these efforts will produce the desired increase in productivity needed to promote economic growth.

The clearly negative consequences flowing from the profit motive under progressive scales of income-tax are partially offset by the struggle to gain social distinction. This goes to explain the fact that the disincentive impact of tax progression on an increase in working effort is smaller than that pursuant to economic calculations. However, this counterweight is weakened as one's gross income increases in accordance with the degree to which status symbols depending on the size of disposable income come to the fore or the degree to which practices involving an untaxed increase in disposable income prevail. On the whole,

therefore, the restrictive effects are likely to predominate. If, in addition, we include the disagreeable consequences linked to the practices for an untaxed increase in disposable income, that heightens even more the negative judgment on the socio-political orientation of progressive scales in income tax.

(b) Any examination of the effect of a progressive income tax on the willingness of entrepreneurs to take risks entails the difficulty that part of their enterprises are subject to an independent flat-rate corporation tax and that the progressive taxation of income only impinges indirectly on the propensity to invest via the progressive incidence of tax on shareholders' income and the customary adjustment of corporation tax to income tax scales. If we proceed on the basis of the profit motive, a progressive income tax undoubtedly exercises a negative influence on the willingness of individual enterprises and partnerships to take risks, because this distorts the relationship between profit expectations and the danger of losses at the expense of profit expectations. Although this applies to flat-rate taxation, it is particularly true of a progressive tax burden, because high investment risks are matched by relatively fewer chances of making a profit. At the same time, we should bear in mind that hazardous investments are particularly important for economic progress, because most innovations initially involve high risks. In order to ensure that such investment takes place, it must of course offer appropriately good chances of making a profit. Yet it is particularly in this field that progressive taxation makes itself felt. As a result, the most important investments for economic growth become unprofitable and fail to materialize.

As *Domar* and *Musgrave* have demonstrated for a flat-rate income tax, the status motivation, i. e. the striving for a higher income through the assumption of greater investment risks which hold out hopes of a larger profit, only plays a decisive role if losses are entirely deductible. In the case of a progressive incidence of tax and the limited amount only of deductible losses (in terms of quantity or time) customary today, it is highly probable that the restrictive effects of the profit motive will predominate.

Furthermore, the progressive tax scales bring about a substantial «orientation of entrepreneurial planning towards fiscal considerations which, alongside the assessment of the market prospects, have acquired a significance for decision-making well beyond what they used to possess. On the other hand, the fact that such tax-oriented planning can lead to a reduction in economic efficiency is undeniable (*Jecht*).

Clearly, a socially oriented progressive system of income tax impairs willingness to bear risks – decidedly so in the case of individual enterprises and partnerships and partially for joint-stock companies – and it restricts in particular those investments on which economic growth hinges to a large extent.

Yet this conclusion contradicts the experience gained during the postwar years. As *Jecht* observed, «it is virtually impossible to furnish evidence in post-war development for existing taxrates to have generally reduced an entrepreneurial willingness to take risks». However, there are a number of special grounds to explain this heavy volume of investment since the War. First of all, the scale of investment by companies has been promoted to a substantial degree by a series of fiscal measures. Firms often faced the option of either paying taxes or else employing these sums for investment purposes. But even then (and disregarding for the moment the tax incentives) the developments of the postwar period can be accounted for by the enormous backlog demand, the buoyancy of international trade etc – in short, by the predominance of «sellers' markets». But we ought to take care not to regard such exceptional situations as the rule and to draw premature conclusions from the experience gathered during such a period.

(c) What effect do socially oriented progressive scales of income tax exercise on capital formation by private households? When seeking the answer to this question, it is most appropriate to assume that «private savings depend on an objective factor (capacity for saving) and on a subjective factor (willingness to save)». This point was made by *Neumark*. The decisive factor for capacity to save is disposable income and that clearly decreases as a

result of progressive tax scales. Since capacity to save among the recipients of larger incomes is comparatively large pursuant to the «law of the falling quota of consumption», the capacity to save is seriously affected by tax progression.

Notwithstanding, the volume of savings depends not only on (objective) capacity to save but also on a subjective willingness to save; and the latter is governed by several motives. The quest for security promotes the will to save, although this impulse will decline in proportion to the speed at which public welfare grows and also extends to the recipients of medium-sized and large incomes. The significance of the profit motive for willingness to save should not be over-rated: it probably ranks highest among those with large incomes. But the progressive impact is also at its greatest there, so that it may well impair willingness to save. Finally, mention should again be made of the status motive as a criterion for willingness to save. If wealth stands to the fore as a status symbol, even a high rate of progressive taxation will only little reduce willingness to save. It should, however, be borne in mind that, in their capacity as status symbols, property and consumption standards «compete» for the disposable income and that the stimulus provided by the former for willingness to save become all the smaller, the more that the second factor assumes importance.

It is therefore difficult to determine willingness to save and this quality has in fact probably declined during the last few decades. However, that probably results only partly from progressive taxation, because the latter exerts a comparatively small influence on the factors determining willingness to save. Of greater significance in this context than the willingness to save is its relationship with capacity to save. The importance of willingness to save for private households will decrease in proportion to the diminution in the capacity to save. But that in particular is the consequence of progressive taxation. We come therefore to the same conclusion as *Jecht*, who left no-one in any doubt about his belief that the «much lamented fall in personal savings as a percentage of total savings . . . is largely due to the high rate of taxation on larger incomes».

However, this fall in personal saving has hardly affected the national investment quota in the post-war years because private savings have been replaced by other forms of financing. Reference has already been made to the distributive and regulative problems which such a change in the forms of capital formation is bound to bring. But even if one leaves them aside, the question remains open as to whether such substitution for saving will at all be possible in the years to come. As far as the self-financing of firms is concerned, that will only be possible under a full utilization of the means of production at the price of a fall in the value of money. But that would widen the differences in personal wealth still further, since small-scale savers would suffer most of all due to their preferred form of saving (bank accounts). Moreover, public investments would not be maintained on the previous scale if other expenditure such as that on armaments and social benefits were to rise and if the State's share of the G. N. P. should not be increased any further. But as a high investment ratio is necessary for an additional rise in real income, it will probably depend in future more than in the most recent past on private savings as to how much net investment and thus G. N. P. will grow. According to *Jecht*, «the true limits to a redistribution of income will probably lie in the effects on investment. Today, nobody seriously doubts that social policy can only prove successful in the long run if it rests on a growing economy.»

(d) But the role of fiscal policy is not only to equalize differences in income, but also to even out the disparities in private wealth. The primary instruments for achieving this are a progressive death duty and a gifts tax. A death duty not only narrows differences in personal wealth, but also indirectly exercises a levelling effect on the distribution of income, because it generates a certain equalization in unearned income. Furthermore, the justification cited for a progressive death duty is that it curtails the inequality of starting conditions peculiar to inherited assets. «However, considerable disadvantages attach to the redistribution of wealth and income attainable in this way and attention to such disadvantages sheds light on the bounds of this method» (*Haller*). A death duty with prohibitive rates (and that is the

quickest way to achieve the desired goals) would impair personal provision for the future of one's family and thus reduce one of the strongest impulses for the human will to work and the private formation of capital. If we wish to avoid the above-mentioned drawbacks, then a progressive death duty and gifts tax can only be envisaged to a limited extent as a means of bridging differences in wealth and income and narrowing the dissimilarities in starting conditions.

If we summarize the results of our observations so far, then a financial policy of social balance beyond certain limits would only seem to be feasible at the expense of increasing real income. For beyond those limits, both the effects which derive from public expenditure on social benefits as well as the consequences linked to a socially oriented income tax and death duty inhibit an increase in performance and detract from private savings. Moreover, progressive scales of tax diminish entrepreneurial propensity to invest.

III

Have the precincts been marked out within which a financial policy designed to achieve a social balance can function? Is there any genuine alternative between social balance and economic growth? I think not. I believe that these two goals can be combined within the framework of an ad hoc economic and financial policy. Any attempt to resolve this problem must expediently proceed from the fact that neither a market economy nor a socialist economic system can function «without a certain inequality between individual pecuniary circumstances». (*Neumark*). The great significance of different levels of remuneration for economic growth under a centrally planned economy was evidenced by some highly instructive observations by *Stalin*. No less importance attaches to a difference in income in a free market economy. In the former case, economic performance is remunerated in accordance with administrative rules and in the latter via the market. It should also be remembered in connection with a free exchange system that the services remunerated by the market include entrepreneurial activities and the «capitalist» function of accumulating and lending out funds. The disparity in the recompense for economic performances leads to differences in income and wealth, which provide a spur to economic growth via the struggle for status between the members of the society in question.

But what degree of inequality in the distribution of income and wealth is advisable for economic growth? Any answer to this question can only possess limited validity and partake of a speculative nature. None the less, it does seem possible to exclude the two extremes of very great and very little inequality because the latter can engender a lack of interest and apathy, while the former sometimes leads to sharp conflict and possibly to public disturbances. The steepness of the gradient in income and in wealth indicates to the individual not only his place on the «pyramid», but also the possibility and the probability of reaching a certain goal in income and wealth. This steepness of the gradient is usually expressed by the «pareto coefficient» p . Its value increases in proportion to the steepness of the gradient: $p = 0$ would signify complete equality of income and wealth.

As *Hofstätter* has pointed out, we may assume «as a general rule that the level of aspiration among the members of a society is dependent in functional terms on the pareto-coefficient (p) of the ranking within the given society. The higher the value of p and thus the steeper the ranking gradient, the higher the individual goals . . . Hence, the ranking competition between the members of a society is probably a function of the pareto coefficient.» In order to attain a maximal increase in the national product, one should accordingly make sure that there are steep gradients in the distribution of income and wealth, because they generate particularly strong stimuli. It should, however, be borne in mind that very great differences in income and wealth may not only stimulate the less favoured members of society, but also depress them. Both of these conditions are highly undesirable from the standpoint of social

stability, but they may in fact probably be avoided or restricted by a flattening of the gradient towards the median values of the pareto coefficient. The slowing of the growth rate which must perhaps be accepted in return does not seem too high a price to pay for safeguarding social stability. Nevertheless, the stimuli provided by the differences in income and wealth can only become really effective if the vertical flexibility or social mobility of the members of a society within the pyramid of income and wealth (i. e. the chance of advancement as well as the danger of decline) are guaranteed to a very high degree. Social mobility is also of great importance because median gradients in the distribution of income and wealth will probably only appear tolerable to the less favoured if there exist genuine and fair opportunities for them to improve their income and wealth. A high degree of social mobility also takes into account the fact that individuals judge their economic situation by their relative place within the pyramid of income and wealth and not by the amount of their income or wealth in real terms.

Where median gradients exist in the distribution of income and wealth, i. e. pareto coefficients of between approximately 0.55 and 0.45, then it is conducive to economic growth and – from the socio-political standpoint also possible under a system of great social mobility – to maintain the existing differences in income and wealth. Such a policy, marked by a close link between its growth and its social components, would bring about a rising level of affluence in society and (if the pareto coefficient remained unchanged) this could be measured against the increase in average income and average wealth. Individual incomes would fluctuate upwards and downwards within the pyramid of income and wealth – similar to individual prices fluctuating around a stable price level. In this way, the goal of an increasing real income (for which a median differentiation in income and wealth is indispensable) could be linked to the objective of a social balance which would be attained here by a high degree of vertical mobility within the pyramid of income and wealth.

The recommended instrument in any policy aimed at bringing about a sustained increase in the GNP and fostering social mobility is to keep prices stable and to permit unrestricted competition, particularly by means of free access to the means of production and unimpeded admission to trade and industrial activities (*Lewis*). In this way, the role played by rank and profit in motivating human conduct is simultaneously rendered fruitful in generating an increase in real income and social balance.

And what are the issues in financial policy? To the extent that the distribution process on the market does not accomplish this on its own, a fiscal policy should bring about the desired average differentials in the pattern of income and wealth distribution and maintain them. The statistics on the number of differentials at present in existence should be determined. There is much to indicate in regard to the developed economies of the Western world that the differences in income lie within the stated median differentials and in the case of the welfare-oriented countries below them. This is less probable in respect of the distribution of wealth – in West Germany no doubt due to the fiscal dirigisme and preferential treatment of the last eight years. The present differential in the distribution of wealth could be levelled off by means of taxation. Since the death duty (which immediately springs to mind in this context) must not be too stringent for the reasons stated above, greater importance attaches to the positive measures for promoting saving among a wide section of the population. Tax relief is probably indispensable if the Government wishes to promote saving among the recipients of small and medium-sized incomes. Steps should, however, be taken to make sure that this does not widen differences in wealth. That may be attained by fixing an absolute limit on the tax-deductible amount or, more effectively, by confining preferential treatment to those taxpayers whose incomes and assets do not exceed a certain limit. An across-the-board preferential treatment for savings is incompatible with the true nature of income tax and, moreover, questionable from the cyclical standpoint.

Once that «average» differences in income and wealth have been achieved, it is a matter for financial policy-makers to maintain these differentials. The progressive scales of taxes could

then be levelled off, particularly in regard to the absolute part of income tax progression. What speaks in favour of mitigating the steep income tax progression in this way (in addition to the negative consequences already indicated) is the fact that too sharp a progressive scale restricts the chances of advancement up the pyramid of personal wealth, thus preserving the differences between «poor» and «rich». In order to maintain average differences in wealth, it would also be feasible to moderate death duties. One could probably also consider eliminating discrimination against distant or unrelated heirs by computing taxes solely on the amount of the estate inherited. That would promote a wider dispersion of wealth. With a view to encouraging the dispersion of wealth among wide sections of the population, it would be prudent to grant comparatively large tax allowances. In line with this idea, it is recommended that a generous flat-rate amount should be given together with a substantial uniform allowance – i. e. an indirect progression.

The other functions of a financial policy which bring about social balance would lose importance as general wealth grows. There will always be old and sick people with insufficient means of subsistence. In that case, the Government must intervene and provide support just as it does for unemployment. But these social benefits will probably be easy to fund because of the rising level of economic productivity. Moreover, minimum incomes will rise as the G. N. P. grows so that the financial position of the poorest members of the community will also improve. If advancement prospects within the pyramid of wealth are to be ameliorated, then the above-proposed partial tax concessions will probably have to remain. The mounting degree of «socializing» the individual burdens which has taken place in recent times and the concomitant increase in the horizontal redistribution of income would prove to be superfluous as and when wide sections of the population were able to look after themselves by means of private savings. Such a diminution of public welfare would also render some of the authorities unnecessary and therefore indirectly help to reduce the volume of public expenditure. The problem of heavier taxation on unearned income would forfeit some of its acuteness if this were to become of interest for the recipients of incomes of all categories due to its wider dispersion.

A policy directed towards such remote goals is probably not easy to translate into reality. But at least a serious attempt should be made towards accomplishing this aim, because it provides an opportunity of replacing the ad hoc extraneous measures hitherto prevailing in social policy by a genuine social balance. The socio-political problems of fiscal policy would then wane in keeping up with the degree of success obtained in promoting economic growth and social mobility by other economic instruments such as competition, open markets and a tight monetary policy.

Economic Problems in Social Security

The Commission of Inquiry on Social Questions

1966

1. Joint Foundations of Social and Economic Policy

A great deal has been written about the contrast between economic and social policy or about the subordination of one to the other. But this approach proved to be lacking in realism and logic and to be politically sterile, even at a time when people still used to regard social policy primarily in terms of re-allocating income from rich to poor – i. e. usually from the propertied class to those living exclusively from manual labour. At most, it seemed to constitute a mutual insurance scheme for the poor. That was also a time when economic policy seemed to be confined to making supplementary adjustments to the «automaticity of the market» or, if at all possible, refraining from making such alterations.

However, this inadequate interpretation of former times has meanwhile become completely unserviceable as a result of changes in social and economic structure, economic advances and above all a shift in opinion on the functions of social and economic policy. As the frequently used term «policy for social security» indicates, social policy directs its attention to situations which can affect anyone irrespective of his present financial circumstances and income, or which are certain to affect everyone (such as old age) and against which the ownership of property can only afford protection in exceptional cases. Today, the bulk of the population is covered by social welfare measures and the small section which does not enjoy this protection sometimes has reason to consider that a disadvantage. Pursuant to present-day theory, however, economic policy embraces among its central functions the safeguarding of the economy against recession (and concomitantly against the social distress of unemployment), the concern about price stability (and thus protection against the social distress of inflation and also against the uncertain future inherent in unpredictable rises in prices), protection against the drastic effects of structural changes in certain regions or

branches and protection against the effects of uneven growth. In other words, social and economic policy deal with spheres of life or groups of people which can no longer be separated from each other. Both of them pursue social goals which cannot be distinguished. They are both directed towards providing abundant, increasing and equitably distributed means of satisfying certain wants and guaranteeing this over a long period of time. Both of them understand by this not only the provision of goods and services, but also a satisfactory integration of people into all spheres of life – consumption and production, place of work and family life, social environment, education and culture.

The real difference between the two lies in their point of departure. Social policy proceeds on the basis of individual circumstances which arouse a need for security and, in the event of certain contingencies taking place, a need for provision. Economic policy rests primarily on the need of the whole community for security and provision: it tries to establish conditions which will guarantee fair distribution. Hence, both of them converge in respect of their objectives. The decisive factor is that this common goal in social policy can be reached via both routes. And that is how we should view coordination between social and economic policy.

To a certain extent, social policy always supplements economic policy, namely in those cases where people have no productive capacity for the market or not enough, either from the very beginning or because of their personal misfortunes which were neither predictable nor insurable as a risk. However, social policy cannot fulfil its chief object – the safeguarding of a dignified social status for all people inasmuch as they need these safeguards – if it believes itself to be militating against economic objectives and if the socially significant functions of economic policy, including in particular the protection of price stability and full employment, cannot be fulfilled. Social policy can never provide adequate protection against mass unemployment or galloping inflation. The fulfilment of economic tasks thus accords with the interests of social policy, which can even play a positive role in this. Equally, the realization of social goals forms an elementary precondition for the functioning of modern economic policy, since this is no longer marked by a tendency to leave the automatic operation of the market to its own devices: it relies on a positive attitude by people to its objectives and on a smooth development of social policy because of sensitive and complex reactions to abrupt changes. These facts may be illustrated by figures. Today, approximately 20% of social income flows via the cash departments of the social institutions, i. e. either the Treasury itself or the social security bodies. But the type of social institution concerned is of decisive importance for the smooth functioning of economic policy – for example by virtue of its impact upon the overall saving ratio, the supply of goods and services and labour mobility.

A. The Need for Economic Policy to Take Social Policy into Account

The precondition of close links between economic and social policy generates a number of disputes whose resolution must never be attempted unilaterally, lest this destroy their concurrence. Such disputes arise for two reasons:

(a) As social policy sets out, first and foremost, to safeguard individual well-being, this presupposes a wide measure of continuity. That becomes particularly manifest in retirement pensions, which are meant to provide a cover for decades. By contrast, many of the functions of economic policy depend on the elasticity and mobility of certain sub-sections of the economy and of individual members of the community in order to ensure the continuity of overall economic trends. That is particularly valid for economic growth and cyclical policy. Like the development of any organism, overall economic growth entails structural change: there are always individual sectors or enterprises which shrink in relative or absolute terms in the course of these shifts in proportions. Cyclical movements come about when individual

influences such as the volume of investment expand more quickly or more slowly for a certain period of time than the national product in terms of real value. Any wish to prevent this at all costs would necessitate a profound inquiry into the basic composition of such influences and thus also into the plans and decisions of individuals with a view to introducing central regulation and to preventing the shifts in proportions concomitant with growth. Economic policy must rest to a considerable extent on compensation, the idea being not to hinder structural and proportional changes but to even them out by movements in the opposite direction.

The need in social policy for continuity in a field accounting for no less than 20% of national income and continuity in its units and sub-units down to individual men and women thus stands in contradiction to the need in economic policy for a continuity which presupposes elasticity among all its subdivisions. This becomes particularly evident when an «overheated» economy requires cuts in all public expenditure, but faces a largely inelastic aggregate of welfare expenditure. Such inelasticity stems partly from the existence of valid claims in law and partly from the strength of political pressure against cuts in expenditure – perfectly understandable as it is with all long-term outlay meant to satisfy the need for security. This inelasticity hampers the smooth functioning of cyclical policy and also renders the granting of compensation in other sectors all the more difficult and arduous, even though they may be just as dependent on continuity.

Naturally, social policy must take this demand for elasticity into account as much as possible. As we shall see, however, the attempts undertaken in this direction have encountered limits and these cannot be extended without substantially disrupting the fundamental principles of social policy. It is therefore not a coincidence that no resort has hitherto been made to the option of not invariably index-linking pensions in the statutory retirement pension and accident insurance schemes, even though this might be cyclically justifiable. By the same token, social security contributions can only be adjusted to a limited extent for the purposes of cyclical policy. It is argued, for example, that higher contributions could be charged during boom conditions and the money deposited at the Central Bank in order to spend it during recession periods when the level of contributions falls. Such a course of action would presuppose, because of the earmarking of contributions, that boom and recession periods follow each other at regular intervals. But if there are long boom phases (as in the recent past), then such action perverts the nature of contributions. They then serve the economic goal of skimming off purchasing power, and the basic concept of self-provision in social security, i. e. the accumulation of claims equivalent to contributions, is destroyed. The contributions then start to resemble taxes. As things now stand, such an attempt involves the danger that the accumulated funds will have to be spent by the authorities at some point of time without them being able to make the latter dependent on cyclical considerations. Due to the lack of regular economic cycles, it has proved impossible, inasmuch as the approach was motivated by cyclical considerations, to apply a sliding-scale over an average period of three years when computing the general basis for amounts payable and in this way to allow the adaptation of rents to lag behind the growth in wages and salaries. At the present time, this means that pensions are rising sharply as the Government manages to steady the business cycle on the strength of modest wage increases.

Wherever possible, the attempt should be made to gear social policy to the given economic situation within the limits of its stated goals and indeed there are sectors such as unemployment insurance and assistance in which the goals of social welfare require this. On the whole, however, social policy can only be used for cyclical purposes if it fits rationally into the predictable framework of growth by expanding its terms of reference. None the less, this demand must be voiced with all the more insistence because the elasticity of a social budget, once decided, is small. The consequence for economic policy – a regrettable consequence from the standpoint of cyclical policy – is that it must reckon with a large block of inelastic expenditure as an ineradicable fact.

Social policy enjoys more opportunities than cyclical policy to promote the mobility of labour and the restructuring of the various branches of trade and industry, in particular by granting retraining subsidies, furnishing active help in finding employment and defining in precise terms «unreasonable» activities for unemployed or incapacitated persons.

(b) Particularly in regard to the collecting of contributions, welfare measures represent interference with the use of earnings made on the market, even where this does not concern a redistribution of income among the various groups of the population. If a situation of offsetting risks and evening out individual incomes clearly exists, then the individual members of the community obtain the equivalent of these contributions in some form or other. At the time when they are levied, however, the contributions represent a burden to be added to that of taxation, although they may not be regarded as such. The fact that such contributions become obligatory argues in favour of the assumption that these sums would have been employed differently if no compulsory insurance had existed. On the other hand, such sums of money benefit the recipients of social security payments and they «consume» them (with the exception of accumulated subsequent payments which are often saved). In other words, social policy may be assumed to exercise a direct influence on consumption, savings, investments etc. Social policy also exercises a similar effect on employment levels in the form of sickness pay, invalidity pensions, retirement pensions etc.

It would largely be a pointless exercise to calculate what impact existing social security would have on the distribution of income, the use of income and employment. To accomplish this, we would have to compare the given situation with one which is not imaginable, namely a situation in which no provision has been made for the sick or for old people and invalids. To that extent, we can but accept social intervention and the outcome of such action as a reality of economic policy.

The situation is different if changes in social welfare are under discussion. In that case, we would have to take into consideration the decisions of social security recipients in regard to consumption or saving in addition to the broad effects on the pattern of income distribution, the use of income and levels of employment. That is a fruitful field of cooperation for economic and social policy – unlike sterile meditation about reality versus possibility!

B. The Need for Social Policy to Take Economic Policy into Account

The need for mutual coordination of a mutually acceptable goal of social action engenders a number of concrete problems in social policy. These are reflected firstly in the size and structure of the social welfare budget (i. e. the sum total of all disbursements on welfare and the requisite or earmarked receipts from the given GNP.), secondly in the growth or reduction of this social budget in relationship to the GNP. and thirdly in the methods adopted under social policy.

Irrespective of the direct objectives of social security itself, the social welfare budget is also limited in regard to both its minimum and its maximum amount for economic reasons. Both these limits are governed by the principle of continuity. But that implies more than just maintaining the status quo and its implications for social peace and more than the need for recognition by one's own contributions of individually acquired claims – all of which are factors which restrict the possibilities of reducing the social budget. A certain continuity is also necessary for economic reasons: a sudden loss in individual income breeds social consequences which, when occurring on a large scale, exercise a negative impact upon economic conditions.

There is above all a need for a continuity in the size, in the pattern of expenditure and in the financial basis of the social services budget from the standpoint of the economy as a whole. Sudden switches in the size and pattern of expenditure produce changes in the use of income (savings, investment, structure of consumption etc), whilst sudden switches in contribution

rates generate passing-on processes and so forth. This can prevent the attainment of the main economic goals, which are so important for social policy – in particular the maintenance of price stability and full employment. If social policy cannot be elastic for the purposes of cyclical policy, then it must at least be continuous so as not to bring about independent movements operating parallel to cyclical fluctuations and almost fortuitously augmenting or weakening the latter.

These observations must not be interpreted as implying that the limits to the social welfare budget are rigid. Nevertheless, they should be taken into account when assessing those reform plans which would imply for wide sections of the population a considerable reduction or increase in claims or else economically relevant changes in savings, financial burdens or consumption habits. That applies, for example, to an absolute or relative reduction in the financial reserves of the social insurance institutions and to a restriction of retirement pensions under expenditure-covering procedures to minimum provision (with those desirous of further cover being referred to voluntary self-insurance schemes). Conversely, it also applies to the possibility of substantially extending the statutory obligation to take out insurance cover. In view of the orders of magnitude in which they operate, all such measures must be adopted cautiously unless they happen to impinge during a phase of the trade cycle in which the concomitant change in the distribution and use of income is advantageous.

Furthermore, long-term economic requirements also mark a lower limit to the social welfare budget because economic policy relies on the role played by social policy in regard to capacity for work and performance, occupational training and mobility. In recent times, economic trends have helped considerably to create new requirements in social security, in particular because of the inability to maintain the principle of price stability – thus inducing people to seek protection against inflation in their old age.

At the present time, when overemployment and price increases possess more topicality than fear of recession, the upper limit of the social welfare budget is determined primarily by cyclical considerations. Every additional sum spent on social welfare tends to influence economic demand and usually increases consumption. Moreover, this must lead elsewhere to certain restrictions inasmuch as full employment prevails so that the supply of goods and services cannot be increased at short notice. In that case, only two possibilities are conceivable: either the opportunities for other potential consumers to spend are directly curtailed or the restriction of expenditure becomes inflationary via price rises, with these forcing some would-be buyers who only have limited financial means to cut their demand in real terms.

The second possibility ought to be ruled out from the beginning since price rises, irrespective of their other disadvantages, always hit the weakest members of society and of markets, i. e. those who are not in a position to compensate for the loss in demand caused by inflation by appropriately substantial income growth (such as above-average wage increases) or even to derive direct advantages from price increases.

If social expenditure is to be set aside in real terms elsewhere, this should be attempted without a *détour* via price increases. Broadly speaking, there are four sectors of economic demand which come into question: consumption, investment, state purchases for communal requirements and exports.

For two reasons, an absolute reduction in expenditure in these sectors – which admittedly is only necessary when the social welfare budget alone or together with other claims against the GNP grows more sharply than the volume of supplies in real terms – cannot be taken into consideration in either of the four sectors named above. In the first place, because it is only really desired in the rarest cases i. e. when it also contradicts the short-term realization of the goals of economic and social policy and, secondly, because it can hardly be resolved without any major disturbances in economic processes (or cyclical disturbances in market economies). The volume of exports cannot be diminished in the interest of the permanent

international capacity of the country's economy. The financing of numerous community tasks by the State such as road construction, education, air and water purification etc ought to be expanded rather than curtailed. Even if it were possible and desirable to cut state expenditure in many places, it would hardly be possible to demonstrate that cuts of this magnitude are feasible and to ensure that they outweigh the expansion of social expenditure. The maintenance of investment is necessary both in the interest of growth of overall supplies as well as in the interest of full employment. A cut in other places in favour of the social welfare budget is only really practicable in the sphere of consumption and there invariably in that of mass consumption, which accounts for well over 80% of total consumption in the German economy.

Similar limits apply to the possibility of expanding the social welfare budget in connection with overall economic growth. We can proceed from the assumption that the German GNP will grow by no more than 4% at most (or 5% in exceptional cases) after the phase of postwar reconstruction of the West German economy has been completed. If the social budget were to grow by more than 4% to 5%, this would mean that other claims on the GNP would grow less sharply or even sink. A smaller degree of growth in other demand sectors in comparison with that of the GNP would certainly prove easier to achieve than an absolute reduction. But here, too, there are limits, stemming partly from the accepted structural policy that all sectors of demand ought to enjoy an active share of growth (most explicitly formulated in the thesis of a productivity-oriented wages policy) and partly from cyclical considerations. This applies in particular to the investment sector and, by implication, to entrepreneurial income and capital. If the authorities wish to levy heavier taxes or impose higher social security contributions on these incomes in order to ease public expenditure, either in general terms or specifically for social welfare, with an ensuing reduction in their share of overall growth, that courts the danger that willingness to invest will decrease and thus cause unemployment or else that the heavier burdens will be passed on to the prices with a concomitant increase in inflation. If we leave aside exports (whose surpluses can also rise, for example in connection with development aid), there remains a relative curtailment in other public disbursements and above all in mass consumption in favour of an expansion of the social welfare budget. Thus, an increase in the social welfare budget competes first and foremost with an increase in real wages.

This makes the upper limit of the social welfare budget particularly unmistakable. Social policy can only raise consumption and the flow of supplies to certain groups of the population either by reducing provision for the mass of the population elsewhere or failing to satisfy communal requirements. The question therefore arises in regard to every social benefit whether it will generate more disadvantageous consequences for the common weal than a renunciation of further measures of social policy. Only if this question can be answered affirmatively in favour of social measures will it be permissible to expand the social welfare budget over and above the average increase in the GNP.

By the same token, the methods employed in social policy must be coordinated with those of economic policy and vice versa. Because the economic system for which West Germany opted is rooted in a free market economy, social policy must observe its fundamental premise, i. e. the dependence of income distribution on market performance and the precept of individual self-provision. On the other hand, those situations which bind people's need for security more and more closely to state activities and render self-provision increasingly difficult spring from the fact that the preconditions of a complete market economy (perfect competition, full market transparency, open and equal admission at all times for all individuals to all markets and occupations, and thorough mobility of production factors) prevail to a limited degree only or else engender undesirable consequences such as cyclical fluctuations.

Only vigorous economic growth can alleviate these difficulties by increasing productive capacity all round, by raising the income of everyone engaged in the economic process and

by expanding the national product available for distribution. Yet it is especially growth which creates fresh problems (in particular for those unable to participate automatically in its benefits) and these obstacles ought to be removed by social policy in such a manner as to encourage rather than hinder growth.

We cannot stress emphatically enough that there are no ideal or straightforward solutions for this whole series of problems, conflicting aims and coordinative tasks. The idea of having economic and social policy «of a piece» is not practicable as long as these two policies continue to operate separately. An economic policy which postulates market-economy principles, yet permits intervention at numerous points or prescribes certain conditions – in the shape of cyclical stability, the fair distribution of fiscal burdens, a balance-of-payments equilibrium, vigorous economic growth, a fair allocation of educational opportunities, the preservation of certain branches of industry, regional balance and so forth – such an economic policy requires social control just as social policy in turn acts as an economic control. As in economic policy itself, the real issue here consists in the attempt at regular and best cooperation between economic and social policy, the coordinating of appropriate measures and the avoiding of blatant contradictions. This all takes place pursuant to the principle that economic policy must be geared to social policy and vice versa.

None the less, the significance of the limits to the social welfare budget and the problems inherent in the above-mentioned coordinative tasks can differ substantially – depending on which influence is affecting the distribution of income. The pooling of all expenditure on social security plus the requisite contributions and taxes within a single social welfare budget does not mean that the whole volume of expenditure and the necessary receipts to finance it are completely withdrawn from the individual use of income. Taxes are always regarded as a deduction of income and the persons affected always try to pass them on in some way if they are increased. Alternatively, this may modify his willingness to work hard. Whether that is the case with social insurance contributions (or at least to the same degree) remains open to doubt. Although these contributions are obligatory in character just like taxes, they resemble the use of income for the purchase of life or health insurance cover inasmuch as they really benefit the person paying such premiums by conferring protection. This fact is reflected at least *pro forma* in the self-administering organization of the social insurance institutions.

This difference between insurance contributions and taxes – and one which is blurred whenever a redistribution of income takes place among the contributors – assumes particular importance when the maintenance of full employment represents a paramount goal of economic policy. By virtue of the far-reaching guarantee of full employment, the conditions for passing on additional costs to prices and the additional burdens to wages have improved considerably. In consequence, additional burdens are now almost invariably passed on – always at the expense of those who, in the final analysis, cannot pass them on any further. As a result, the above-mentioned question gains decisive importance: are insurance contributions deemed to be a burden like taxes and therefore passed on in similar fashion? Inasmuch as additional insurance contributions are usually calculated as costs and then passed on, the link between the social insurance budget and the growth of the GNP is very much closer than it would be otherwise. As there always exists a chance on the one hand that insurance contributions will not be regarded as taxes and not passed on to prices because of their unpredictable effect and on the other that they will be definitively borne by the contributors who finally benefit from them, the social welfare budget can become somewhat more flexible.

In economic terms, it is expedient to distinguish between a social policy directed towards providing an income when a person is no longer gainfully employed and secondly one aimed at achieving a genuine spreading of risks in the course of an individual's private life and thirdly one aimed at redistributing income. The former case concerns itself directly with the individual income earned on the market; however, part of this income is retained so as to be

able to give it back to the same person at another point of time, usually in old age. Viewed from the individual's standpoint, it constitutes a form of saving – irrespective of whether the type of financing selected is an expenditure-covering method (with contributions adjusted annually to a level which should cover the year's outgoings) or a capital-covering method. This recognizes both the redistribution of income accomplished by the market or by democratic forces such as trade unions and employers' associations as well as the principle of individual self-provision – even though it is compulsory in this case. The same holds true of a genuine spreading of risks, only that in this case it is not an act of saving, but one of insurance. Hence, we can only speak of interference with the original distribution of income if it involves a genuine reallocation of income among the various groups of the population.

None of these three alignments under the present system of social policy can be realized in their pure form, but certain priorities may nevertheless predominate. The nearest approach to an equalization in income between the various stages of human existence is the retirement pension provided under the statutory pension schemes. Even though the individual (or his employer) pays the contributions direct towards the financing of the due pensions, the annual rises in his claim to a pension and the calculation of the individual basis of valuation pursuant to the ratio between one's individual income and the average income of all insured persons reflect the fact that the individual pension entitlement rises in line with higher contributions. Even if no precise equivalence ensues, an attempt is nevertheless made to achieve it approximately by means of this system for determining individual contributions. This system thus embodies the principle that a pension should reflect one's former income. If one were to capitalize the contributions and pay interest at the customary rate on the market for fixed-interest securities, the index-linked pension for a wage-earner (computed pursuant to the valid formula and the customary delay of one year) who had paid contributions for 40 years at the present rate of 14% and who reached precisely the average expectation of life after completing his 65th year of age would in fact approximate to the sum total of his own contributions.

Provision is however also made to cover two risks, early invalidity and longevity, which are invariably linked to an equalization of income during the course of an individual's life. Furthermore, the present scheme allows for a whole sequence of corrective adjustments amounting to a genuine redistribution. In part, these flow from the fact that the valid provisions have only been in force since 1957. As a result, the present old-age pensioners are receiving more than the equivalent of their own contributions (including the equivalent of contributions paid prior to 1957 plus interest and compound interest). The change in the age structure of the population has also been accompanied by a further redistributive process. In view of the valid formula based on the annual adjustment of contributions to a level which should cover the year's outgoings, present-day contributors pay less than future insured persons will have to bear due to a less favourable age structure. Thus, contemporary contributors benefit from this situation and will continue to do so as long as the adjustment of pensions actually takes place at the higher rates than the average market rate of interest.

The basis for a redistribution of income is also to be found in the reckonable periods of former contributions. There are three different processes, two of them redistributive in nature. Where the State pays contributions for servicemen during their period of military service, these are in fact borne by the taxpayer: however, such payments form part of a soldier's pay just as an employer's contributions form part of wage costs. Hence, one cannot speak of redistribution in the narrower sense of the term, just as military pay or civil servants' salaries are not redistribution but remuneration for work. However, there is a redistribution of tax monies among insured persons by virtue of the Federal Government's subsidy. This redistribution brings about a departure in the pension scheme from the insurance principle and, for that reason, it needs careful re-examination. It is never possible to pinpoint precisely on whom the tax burden finally falls because of the different opportunities for passing on taxes in accordance with one's individual position or cyclical circumstances. We must,

however, assume that it mostly impinges upon the income of the masses. For that reason, redistributive processes of that kind ought to be reserved to those persons among whom the socio-political motive for divergence from the insurance principle carries more weight than the probable burdening of mass incomes. The second form of redistribution is more precarious. The Government subsidy only covers about half of the funding of all those burdens other than retirement pensions. As a result, these burdens must be financed from the contributions. To this extent, contributions partly assume the character of risk premiums and partly that of taxes – in the latter case only inasmuch as contributors do not bear a specific risk (e. g. single persons do not run the risk of leaving behind a widow). Whether or not the flat-rate contributions paid by a limited and prescribed group of insured persons results in a «fair» distribution of these burdens must be open to doubt. This proportional distribution of burdens does not correspond to the criteria of fairness applied in taxation. If should also be borne in mind that some individuals are not eligible due to the limiting of compulsory insurance whilst some are eligible to a certain extent only, because they earn more than the limit up to which contributions are chargeable. If, therefore, these forms of redistribution seem necessary for socio-political reasons, the Government should consider whether they ought to be financed by the contributors or by the general mass of tax payers.

The clearest case of offsetting risks is that of health insurance. This, too, involves redistribution – admittedly only within the income limit up to which contributions are chargeable and moreover only between insured persons i. e. without drawing on the recipients of higher incomes – inasmuch as the contributions remain equal in percentage terms but differ substantially in absolute terms depending on the size of one's income, whereas the benefits in kind are absolutely the same for all in accordance with the given risks. Furthermore, the subsidies paid to hospitals etc may be regarded as indirect redistributive processes in favour of people covered by the health insurance scheme. In the case of other provision against risks, the individual does not receive the equivalent of his payments; but he does receive the equivalent amount in security, since the risk can affect everyone. Accident insurance also approximates to a full cover of risks.

By contrast, the most explicit example of direct redistribution in the true sense of the term is public assistance where the recipients of such welfare do not have to render any performance of their own in the form of reckonable contributions. The examination of whether redistribution is justifiable in this case and for protracted ailments and diseases is relatively easy, because the provision of care for these people is a social necessity irrespective of who bears the burden.

A special problem (and one to which we have referred on several occasions) is the question of whether the choice of an expenditure-covering method for statutory pension insurance may in fact constitute a form of redistribution, since the contributors actually pay their due amounts for the benefit of non-contributors and thereby obtain the entitlement to be looked after by the gainfully employed during their own period of inactivity. From the standpoint of the individual contributor, it is a matter of indifference for the quality of the entitlement whether his contributions serve to build up a capital fund which is then used for the payment of pensions or whether they serve to meet current expenditure. In economic terms, the difference is only a qualified one.

As regards individual businesses and households, every accumulation of future entitlements is a capital claim or rather every capital claim (provided that it is not prematurely realized and converted into a claim against the present, but intended to guarantee a later rent) is simply a claim against the future. For these claims must always be paid out of the net domestic product of the active factors of production, whether directly by the insured persons as under the expenditure-covering procedure or in the form that the State has accepted the paid-in contributions as credit from the taxpayer or else indirectly by future savers if one assumes that the paid-in money has been invested in order to yield a return. For it is not the real assets financed from these contributions but only the yield derived from

productive utilization which can be consumed, i. e. unless one is prepared to forgo reinvestment.

If a capital fund had already been available and productively invested in the past in addition to the saved capital, the national income would be higher by the amount of the yield on this capital than it would be without the capital fund; and retired people would be easier to provide for. The current additional accumulation of such a capital fund on a grand scale must not foster any illusions. As we of course know that the present generation of old people will have to be looked after in any case, the accumulation of such a capital fund would in any case only be feasible via an additional waiving of consumption. This may well be desirable within certain limits in times of an overheated boom; and we have no intention of arguing against additional saving. But it would seem inapposite to prescribe the dual role of making the present generation (encumbered as it is with the old-age «pension hump») provide for the old people and also amass capital funds. Moreover, such de facto compulsory saving at the present time in favour of a future characterized by better economic prospects due to the present pace of economic growth is difficult to justify with any conviction. We can therefore assume in regard to the present time that an aggregation of claims now exists, but that these are not formally disclosed under the expenditure-covering procedure. Whether or not such a disclosure ought to be made is a matter which we shall examine at a later stage.

II. Size and Pattern of the «Social Welfare Budget»

By this term, we mean the entire range of financial means employed for any kind of social benefits and the raising of such funds inasmuch as this takes place statutorily within the framework of public institutions. Like other demarcations, it is to a certain extent arbitrary such as is also the case in the differentiation made between private voluntary provision and legally obligatory provision for the same social circumstances. If the situation involves a hedge against risks, both sets of circumstances establish a claim on the whole body of insured persons. If the situation involves an equalization of income in old-age, they establish a claim against the future and it is for economic policy-makers to safeguard this even though they may employ differing methods in so doing. To this extent, the following data are in fact incomplete.

In this context, social expenditure signifies such items as are normally included under social policy. In other words, the term «social policy» is given a narrow interpretation rather than the wider one of social action and welfare in general. The expression «social welfare budget» may be construed as including the outlay on retirement pensions, accident -, invalidity - and unemployment insurance and equalization of family burdens. It also embraces the totality of spending on war damage, equalization of burdens (to compensate sufferers from war damage) and public relief. Consideration should also really be given to all the concessions provided for the recipients of modest incomes such as lower rents and reduced fares. The magnitude of today's spending on social benefits may be roughly assessed from the conspectus of public benefits issued by the Federal Ministry of Labour. This indicates a figure of DM 47,400 million or 17,3% of national income in 1962 compared with 15% in 1956, 16,5% in 1950, 18,4% in 1933 and 10,4% in 1927. The figure of DM 62,400 million quoted for West Germany by the Statistical Office of the European Communities for the year 1962 includes the benefits in kind, capital transfers, administrative burdens etc.

As regards receipts, these cannot be specified so precisely for the social welfare budget since only part of this revenue (in particular that of the social insurance institutions and the Equalization of Burdens Fund) is earmarked for a special purpose - mostly via contributions. The other part (amounting to about one quarter pursuant to the survey issued by the Statistical Office of the European Communities) stems from general tax revenue.

The social welfare budget has a natural tendency to swell: this is partly an automatic process, and partly due to political factors. Certain influences tend to make the social welfare budget expand in parallel with the nominal national product (though not necessarily with the national product expressed in real terms), whilst others ensure that the social welfare budget grows even faster than the national product in nominal terms.

The first case applies to index-linked pensions inasmuch as the insured persons' wages grow parallel to the national product at nominal value. It also holds true, albeit to a lesser extent, of all assistance to individual incomes which is not automatically index-linked but which must be increased in practice from time to time if the authorities do not wish it to lose its whole point. A similar situation exists in regard to benefits in kind for health insurance institutions. It is conceivable that the latter only increase by the rate of increase in prices. But in view of the fact that the claims on medical care are growing and the facilities for medical provision are also expanding, it is illusory to assume that this growth in benefits in kind can be curtailed.

A trend towards a disproportionately large growth in the social welfare budget has been taking place among the statutory pension insurance institutions because the national age structure is deteriorating. The growth in expenditure will approximate to that of the GNP, even if the ratio between old-age pensioners and gainfully employed persons remains constant on account of the index-linking of pensions.

Another virtually inevitable development is the disproportionate growth in the GNP due to the fact that every legal provision on social welfare creates marginal cases involving special hardships. The wish to eliminate these often leads to a widening category of beneficiaries.

The attempt at harmonizing social welfare benefits within the framework of the European Economic Community will probably generate a disproportionate growth in the social welfare budget. As is well known, the distribution of such benefits among the different sections varies considerably in European countries. In West Germany, for example, the main priority attaches to provision for old people whereas in France the chief preoccupation lies in achieving an equalization of family burdens. Even if one ought not always to choose the most favourable benefits as the basis for assessing the whole scheme, it will hardly be possible in view of the basic principle of preserving the status quo to provide harmonized social welfare benefits in a manner which does not imply any disproportionate expansion of the social welfare budget.

Even very small increases of only a few per-cent in the overall scale of claims on the GNP («social consumption», consumption by the gainfully employed, investment, government consumption, exports) trigger price increases of the same magnitude whilst reductions produce unemployment. Once that a divergence of only a few per cent occurs, it usually tends to increase automatically since price rises result in the planning of higher investment, higher wage demands etc with a further expansion in the claims on the GNP. By contrast, a loss of gainful employment produces a fall in income, consumption, willingness to invest and so forth. However, both these phenomena (i. e. price increases and unemployment) rule out not only a rational economic policy but also a rational social policy, whatever they may look like in practice.

The expression «rational social policy» implies one which deliberately remains within the framework of the above-described limits in order to prevent social security in general and its mode of financing in particular from producing graver social disturbances elsewhere and also, by virtue of a lack of cooperation between social and economic policy, from narrowing the limits within which social policy can operate. Social policy also implies adhering within such limits to an order of priorities regarding the importance of the various functions.

It is not possible to maintain all of these principles in the event of price increases and unemployment.

In today's circumstances, it remains largely unknown in the final analysis how much renunciation in demand and consumption will ensue from price rises. All the claims made on

the GNP are now more or less geared to reacting to price rises. Taxes increase automatically and with them also wage demands, government expenditure and investment. The renunciation of demand enforced by price increases affects those people less able to respond swiftly to rises or to offset them by appropriate demands. It is never possible to predict exactly who such persons are, so that the social consequences of price rises simply cannot be predicted. Only one thing can be affirmed with certainty. The more that groups of the population and of entitled beneficiaries learn to protest against price rises, the more that the impact of price rises and social hardships will affect those unable to defend themselves.

A large volume of unemployment always transcends the bounds of insurable risks. Nevertheless, it is easier to enforce additional measures through deficit financing in a situation of underemployment, because they create additional demand and stimulate economic activity. But as such measures are difficult to annul – unless confined to unemployment payments which automatically come to an end when economic conditions improve – the pursuit of a rational social policy in the above sense of the expression remains a doubtful weapon in cyclical policy. By nature, social policy rests on long-term considerations: it can only be implemented in a rational manner if economic policy-makers succeed in preventing excessive cyclical fluctuations. Unemployment insurance only brings a palliation of a grave social evil, not its elimination. With this in mind, the necessity arises with greater urgency for the makers of social policy to effect precalculations and in this manner to determine the magnitude of the financial charges and claims so as to coordinate them with the aim of cyclical policy.

The fact that social claims in particular should not be absent from such a forecast is obvious from their volume which, as already mentioned, accounts for 20% of the national income. The trend in the social welfare budget to grow more sharply than the GNP cannot fail to produce price rises and social distress unless steps are taken to ensure that the claims of other sectors of demand expand more slowly. Only if the anticipated scale of expenditure is well known will it be possible to determine whether such burdens – together with other (fiscal) charges – exceed the peak load which may be considered reasonable without economic and social harm.

Such a forecast would therefore at all events have at least to be made on a medium-term basis – however difficult that may be in many spheres of social policy because of the dispersion of the responsible authorities and the frequent reliance on specific price trends (e. g. for medical services). Since the social charges either accrue direct via government budgets and therefore in any case form part of such medium-term forecasts or else constitute a kind of fiscal burden, the arguments relevant to the budgets also apply here. Finally, the necessity of a medium-term forecast of social expenditure and of reliable receipts, too, is underscored by the fact that social welfare measures place a greater financial strain on future years than the year in which they are decided upon by law and almost on a wider scale than other public measures. Moreover, this is often quite predictable.

A medium-term precalculation of disbursements on welfare and the revenue needed to cover them must not be seen as a binding estimate – certainly not in a free market economy. Many situations show that the outcome of such precalculations is not desirable, either in terms of social or economic policy. The positive function of precalculations is to serve as the foundations for rational decisions. It is only on this basis that one can talk sensibly about whether and when additional goals in social policy can be tackled or not, which of them must be assigned top priority, which of them should be postponed in the interest of price stability, which social measures can be reduced in scale due to their loss of priority in the course of economic development, what other claims on the GNP can be curtailed in favour of additional social expenditure and, first and foremost, what effects these measures could produce for the distribution and utilization of income. All the relevant social problems can only be judged in regard to their impact: a sound discussion is only possible when such precalculations have been completed. And this applies to the problem of the mountain of

pensions faced by the statutory pension insurance funds, the attempts by many groups to introduce more private or voluntary insurance schemes together with a reduction in the load on statutory pension funds (so that they will only have to furnish minimum cover), the incorporation of wider circles of the population into all sectors of social security, the improvement of facilities for long-term sufferers and invalids and continued wage payments to workers absent sick.

That is particularly valid in times of economic boom. Even if the rare case occurs that such changes do not entail larger overall expenditure, they nevertheless at least place a heavier burden on certain sectors to the benefit of other sectors. But we must postulate in the case of an overheated economy that these additional charges can be passed on directly as far as the employers are concerned, or indirectly via higher wage demands in regard to employees. These higher costs are then reflected in prices. But many factors conduce to justify the waiving of such innovations and changes (unless urgently necessary) in times of an overheated economy in which further price rises seem virtually inevitable in any case. Only when stable prices have been achieved and it has become predictable in what way overall claims on the GNP can be reconciled with the overall available means are the authorities able to judge whether or not such measures are advantageous or not and whether the concomitant charges can be reasonably shouldered by those who have to bear the burdens aimed to ensuring price stability. At all events, it may be deemed certain in times of overheated economic activity that the disadvantages of reorganizing the social fabric are greater for a market economy, because they lead to price rises and thus to a wide measure of destruction of the foundations of the market economy.

This largely invalidates the argument that the preparations for such a precalculation in the social welfare sector would take up an undue amount of time given the present state of social policy.

If we proceed from the assumption just made that the size and the growth of the social welfare budget must be limited if they are not to aggravate inflation and to elicit fatal economic and above all social consequences, then all the more significance attaches to the attempts to counteract these growth tendencies by switching to voluntary schemes. Such efforts rest on the assumption that more and more individuals are in a position, because of their rising incomes, to shoulder a large number of life's hazards and a growing segment of the requisite provision for old age. Be that as it may, three arguments militate against this train of thought:

(a) Unless the principle of recognizing acquired entitlements is to be abandoned, the disbursements must continue in full on the present scale in all sectors of social security designed to equalize income in the various stages of human existence. This applies in particular to the statutory pension insurance funds. That brings us to the problems of a dual burden on the present generation. A transfer of these responsibilities to the private sector might delay the impact of the financial strain, but it would not relieve the national economy from the pressure impinging upon it in the long run.

(b) Both as regards the equalization of individual income during the various stages of life and the offsetting of risks, the hitherto valid statutory form of insurance may be characterized in part as a genuine redistribution of income. The latter is financed partly from taxes and partly from the revenue paid by the compulsorily insured. If the State wished to subsidize the privately insured in similar fashion, a changeover to private schemes would imply that the government-decreed redistribution would be reduced to the detriment of those withdrawing from obligatory social insurance or else that the character of private insurance would be distorted. A redistribution solely between the insured persons such as takes place within the framework of statutory health insurance is hardly imaginable on that scale in the private insurance sector. As we have already stressed on several occasions, this is in any case extremely problematic.

(c) A strong movement against a changeover in social security to private schemes is also

triggered by the actual or imagined growth of hazards for the individual due to his greater dependence on the successes and failures of economic policy and his isolation in a modern mass society. A private person cannot, for instance, insure himself against a risk such as the depreciation of currency.

When judged on their own merits, all these objections are convincing in part only. They are hardly likely to inspire any fundamental rejection of the whole concept of «reprivatizing» social welfare benefits. On the other hand, they do make it clear that the pace of such a return to private insurance would necessarily be so slow and the difficulty of conversion so pronounced as to render the attainment of any substantial relief for the social welfare budget unlikely in the foreseeable future.

With this in mind, it is not clear how the problem of a social welfare budget evincing a tendency to rise disproportionately can be resolved by switching social burdens to the private sector, reorganizing methods of finance etc. In fact, the only real solution imaginable would be for a medium- and long-term overall social welfare budget to be drawn up and for this to be linked to a medium-term and long-term precalculation of the development potential of the whole economy. In reality, there is not much point in effecting individual precalculations such as those carried out for the statutory pension insurance funds for periods of several decades by means of actuarially valued balance sheets. Although these methods furnish insight into the additional pressures likely to accrue from the pension insurance sector, they do not permit any assessment of whether such burdens are reasonable. When viewed in isolation, however, they seem reasonable. Whether or not they still seem to be so when seen in context depends on which social welfare items may be regarded as urgent and with what other claims on the GNP they have to compete. Real and valid decisions can only be taken on this basis when a comparison has been carried out of the urgency of the demands made on social policy, investment volume, development aid, the satisfaction of communal requirements, the expected growth in GNP and the productivity-oriented wage rises needed to maintain a continuous willingness to work at a certain level. Only the ascertainment of the relative value of this competition furnishes insight into which claims may be seen as more important in the medium and long-term and which can actually be satisfied in the light of the expected growth in GNP. As long as such a social welfare budget is not drawn up for at least a medium term of three to five years and viewed in terms of the overall national accounts, there can be no possibility of making any concrete statement on the future of social welfare expenditure and its degree of acceptability.

III. Special Aspects of a Coordination between Social and Economic Policy

A. The Institutional Separation of Insurance and Redistribution

Both within the above-described framework of cyclical considerations and also for the purpose of adopting a systematic approach to our subject, we must pay special attention to the relationship between a genuine redistribution of income during the various stages of a person's life and the provision of cover against risks. In accordance with the fundamental decision taken above, priority should be given to the last two points wherever this is expedient. One way of doing this would be for these different alignments in social policy to be more clearly separated from each other in institutional terms.

Such an institutional reorganization would afford the advantage of greater transparency – an essential basis for national policy. In particular, an explicit commitment to redistribution would be necessary in those cases where this cannot be replaced in a socially equivalent form by an «intertemporal income equalization» (i. e. between the various stages of life) or spreading of risks. The institutional separation would promote the additional voluntary safeguards and facilitate equal treatment for voluntary and statutory social security by creating, in those places where no redistribution occurs, identical or at least comparable

competitive situations for both private and public insurance bodies. Under the present system, one can never find out to what extent someone covered by a statutory insurance fund is favoured or handicapped by redistribution. All of this would be linked to the probability of greater fairness in the distribution of burdens. The absolutely indispensable redistribution process can be better achieved within the framework of a progressive tax system covering all members of society than via the collection of income-based contributions from a more or less arbitrarily delimited category of insured persons:

This last point can be translated into practice even without any institutional separation if it can at least be ensured that all genuine redistributive measures are financed out of tax proceeds and every intertemporal income equalization and hedging of risks out of contributions. There also exist other arguments in favour of the present arrangements and these are not merely traditional ones. As I have already stressed, the various alignments are connected with each other in practically all sectors of social policy. It would hardly prove possible to rearrange this situation, for example by changing over retirement insurance entirely to intertemporal income equalization or health insurance entirely to the hedging of risks, particularly during boom conditions, without economic and socio-structural damage.

B. Employers' und Employees' Insurance Contributions

There is much to be said for the idea of merging the social security contributions compulsorily paid by employers with the employees' contributions. The whole distribution of income would not basically change since these employers' contributions must be regarded both in terms of individual companies and the national economy as part of labour costs and therefore reflected in firms' calculation of costs and in the formation of prices. Only in extremely unfavourable conditions for passing on these sums of money can it be assumed that employers' contributions actually have a profit-reducing impact. Such conditions are then simultaneously the sign of an unusual employment situation, whether in general or in specific branches of industry. They thus represent a problem of general cyclical and at least structural policy, but not specifically social policy.

The replacement of employers' by employees' contributions would offer the advantage that every individual – at least in the case of intertemporal income equalization and the spreading of risks – would be able to discern clearly to what extent he was contributing to his own insurance.

On the other hand, much can be adduced to argue for a division into employers' and employees' contributions (or even for pure employers' contributions such as in accident insurance). One point is that this establishes an institution and thus consolidates cooperation between employers and employees within the social insurance funds, thus ensuring that both sides derive an interest from a sensible limitation of benefits within the framework of what is acceptable from the standpoint of the national economy – without the interposition of a social welfare budget. We must leave aside for the time being the question of whether this socially and economically valuable cooperation constitutes an adequate reason for maintaining employers' contributions or whether it might not be accomplished by a different method. However, as long as the contributions partly finance genuine redistributions as under the present arrangements, it can be argued in favour of employers' contributions that the circle of those who pay these contributions and then pass on the amounts in the price of their goods is wider than the circle of insured persons. But it must be open to doubt, in view of the oft-cited unpredictability of the passing-on processes, whether this widening of the circle engenders a larger degree of social justice.

Section III

Property and Wealth

On the Maximum Protection for Private Property

Hermann Heinrich Gossen

1854

[. . .] Apart from the regulation of the monetary system, the most important thing is to give the individual citizen an opportunity to act in accordance with natural laws, to reassure him that he will enjoy the undiminished fruits of his work. The need for this reassurance was so widespread among mankind, even in earliest times, that we encounter continuous efforts to attain this certainty in the most appropriate fashion in any age of past history that we may elect to consider.

In our present epoch, this has been done in well-known manner via the legislation on personal protection for the individual and for his property on a scale commensurate with his requirements. Such laws have rendered it certain that everyone is in a position to determine with adequate precision and security the extent to which he will enjoy unabated the fruits of his labours. This is such a familiar fact as to make more detailed description superfluous.

It is astonishing to think of the aberrations of speculative minds in recent times when the belief has been expressed that the partial or complete destruction of private property could promote prosperity for all. I refer, of course, to the goal of communism and the different gradations of socialism. Irrespective of any theoretical propositions, every page of history has taught us that nations progress towards general prosperity in keeping with their ability to safeguard private property. The North American Indian has remained stuck at the same level of economic development for centuries: he only possesses a few horses and a handful of tools in his wigwam and these are liable to theft every day of the week. As regards his hunting grounds, he only owns these jointly with the whole tribe and moreover has to defend them against the incursions of neighbouring tribes. We discover that a similar situation existed among the old Germanic tribes according to the descriptions in *Tacitus*. Only when South European property customs began to gain acceptance in the woods and forests of Germany do we find the ancient Germans, either completely naked or clothed in superficially prepared animal skins for warmth in inclement weather, deciding to pursue husbandry and to enjoy the comforts of a settled existence.

The only complaint heard during such metamorphoses of daily life was that certain individuals succeeded in exploiting the masses so much that they were reduced to the proprietorial status of American savages as a result of the emergence and development of various stages of serfdom and bondage. As long as this condition persisted, the degree of personal wealth remained unchanged. Only when the barrier was breached and when the burghers and then the labourers attained greater success in securing the fruits of their efforts did their personal wealth begin to expand continuously.

Two facts are unmistakably to blame for the misguided speculations such as hold sway in communism and socialism. One of these is the inclination of contemporary man to create values by virtue of his activities even if they bear no direct relationship to earnings. The other fact is that certain institutions have apparently generated highly disadvantageous consequences for the working class – consequences which have simply been ascribed to the pattern of ownership in modern society. The first of these two realities led some people to assume that man does not need the attraction of acquiring property in order to induce him to pursue a productive activity and to embark upon a sustained effort. And so it came about that men, who made it their business to remove the supposed disadvantages inherent in the pattern of property ownership for the «working class», lapsed into the same error regarding property as the moralists have been committing for millenia in respect of self-indulgence. As they could not find any effective means of eradicating the clearly discerned defects, they deemed the latter to be inseparably bound up with property. Akin to the moralists and their frequent bans on pleasure-seeking, they felt they could remedy the recognized abuses simply by abolishing private property.

Apparently, the first-named fact has its roots in the laws of pleasure-seeking i. e. that the persistent and regular pursuit of a meaningful activity results in a steady diminution in the concomitant complaint: it finally develops into a more or less pronounced form of *lotus-eating*. Hence, when we find so many people in modern life working because of the pleasure they derive from activity, the reason for this is plainly that these people were forced by virtue of the circumstances of their life to obtain instruction in their youth which then invariably promoted this phenomenon in later years. Any change in these conditions, which thus form a prerequisite for this phenomenon, must necessarily generate a corresponding change in the latter. In our particular case, the removal of private property would cause the most disadvantageous effects, at first in perhaps less obvious form but in the course of time on an increasing scale. For the very reason that the people of our time once acquired and now have a firm command of these advanced skills, it would perhaps be possible on the strength of other considerations to keep them interested in their present activities without the explicit appeal of acquiring property. Yet even if these other considerations were to give some people a complete substitute for the loss of property, such surrogates would nevertheless in most cases provide fewer incentives and therefore dispose men and women to relax the pace of work at their everyday activities. We have all made the following general observation in life: as soon as a certain assignment is to be carried out by common efforts, then everyone attempts to avoid doing as much of the burdensome work as possible – even where everyone holds the same interest in seeing the business consummated. This slackening in the pace of accustomed activities then reduces the volume of consumable goods and satisfactions produced by work but, at the same time, makes itself keenly felt in regard to the education of the rising generation. The reason is because, in their case, the duties to be performed need to exercise the greatest possible attraction in order to overcome the greater resistance prevailing among unskilled young people. In this way, not only the wealth of the present generation will diminish but also the rising generation will obtain less instruction, thus resulting in a further diminution of productivity and of education until the human race reaches the point at which the savage tribes of North America now stand.

Nor is it a valid argument to point out that the size of the population now renders it inconceivable that the mass of the people of our time could revert to a condition such as exists

among savages. The growth in the population of the world is only a consequence of increased prosperity and of enhanced human training so that a fall from that higher level would also bring about a reduction in the number of people, since the connection between the size of the population and degree of affluence has long since been noted and accepted.

Clearly, it is inadmissible to conclude that private property is dispensable simply because many people in our epoch go about their work willingly and docilely, even without the attraction of acquiring property of their own. As we have already seen and shall see even more plainly, the distress of the working class does not lie in the pattern of property distribution; and their troubles cannot be rectified by abolishing private property. In addition, it follows from the above observations on consumer's benefits and personal satisfactions (and thereafter on the rise and fall in values of goods depending on an increase or decrease in the available quantity and the manner in which the prices are formed) that only private ownership forms the yardstick for determining the appropriate quantities in which a certain article is to be produced in accordance with the given conditions. For that reason, the central authority envisaged by the communists for distributing the various kinds of work and for determining their scale of remuneration would soon find out that it had undertaken a task whose implementation exceeded the strength of individual people. Hence, an indispensable prerequisite for the continuation of human society consists in the greatest possible protection of private property, irrespective of whether the owner himself has the benefit of it or intends to transfer it to others for their enjoyment.

We have already noted that the protection of the individual and of property under our legislation is, broadly speaking, adequate for ensuring that everyone can determine to what extent he will enjoy the fruits of his work. But it is not sufficient to assure every workman that:

1. He may undertake and pursue any production which seems advantageous to him; or that
2. Everything which must be regarded as the fruit of his work will accrue to him and that he will not be prevented by law and his fellow-men from making the most expedient use of what he has acquired.

The faulty provisions enacted in this sphere are so numerous that I deem it to be most expedient for the reasons cited above to confine my observations to discussing the two above-mentioned categories under which these mistakes may be classified.

As regards the first category – the inadequate protection afforded to the individual – the following description should suffice. If the protection of the person is intended to enable the individual to act in accordance with the inherent laws of nature and to live in accordance with the religion of the Creator, the safeguards provided must not confine themselves to protecting persons against active attacks from their fellow men, but also accord them perfect freedom to do as they please inasmuch as the action does not constitute any active interference with the same rights available to their fellow men. This latter safeguard is not only lacking in our laws in a large number of cases: it is also impossible because the legal provisions in question prohibit the individual from doing certain things. Hence, these laws do not merely fail to use their powers to protect the individual, but also serve to render it impossible for him to obey the religion ordained by our Creator.

This mistake occurs whenever legislation makes the pursuit of a certain branch of production dependent on arbitrary conditions, thus occasioning difficulties instead of eliminating these unnatural obstacles. These fallacies of legislation are on the one hand a result of the same presumption which is an outcome of positive religions; on the other hand, the legislative errors are induced by a misguided definition of the sphere of individual human rights to be protected.

Given the progress made by the human race in regard to knowledge and skills, it could not remain unrecognized that every branch of production can only operate for the benefit of the producer and for the whole nation if the producer has previously acquired all the knowledge and skills fundamental to the production in question. Despite this recognition, people were

very often seen making an attempt to engage in a branch of production without having first acquired the requisite training and doing this all the more frequently, the less advanced the general education of the masses. This then led to a similar conclusion to that reached by the moralists. They believed namely that in human nature the strength is lacking which could induce individual human beings to act with expedience in this field, and the authorities therefore hastened to create this strength by making the manufacture of certain goods dependent on examinations, concessions and so forth. Various individuals arrogated to themselves a judgment on whether their fellow men would be in a position to create adequate economic values for mankind, whereas clearly only the whole community itself possesses the competence to do this! Indeed, some of the individuals in question believed themselves able to determine how many people could be fed and housed by means of a certain branch of production at a given place and there upon prohibited or aggravated any new establishments in that town as soon as the computed level had been reached! Apart from this erroneous conclusion, the other errors committed were compounded by the acceptance of money as the yardstick of value. Pursuant to this view, an improvement in the economic position of an individual was impossible without increasing one's accumulated sum of money and that only seemed feasible at the expense of one's fellow men. Because of this attitude, many individuals took a hostile stance towards the mass of people and accepted the proposition that they could only grow rich at the latter's expense. As a result, everyone felt that he should cut himself and his family off from the generality of people and zealously make sure that none of the powers exercised by a member of the family was ever forfeited. This view spread and, in consequence, the legal purview for every member of the community was measured pursuant to this criterion. Furthermore, that led to the whole classification of human society in accordance with a certain order of precedence and also engendered the unworthy view whereby one felt sorry for someone constrained to move down from a higher to a lower caste. The adherents of this view also believe that it is natural for the daughter of a beggar to be forced to become a beggar in turn whereas she has, in fact, the same right to be in the world as a princess. We can similarly assign to this category of errors all restrictions in industry and trade, whatever their formal designation.

As we well know, once that man has become acquainted through education with the Creator's true religion, the strength which inspires a person will not simply lead him to obtain the most apposite training for the chosen branch of production but also to carry out this work in the manner best suited for the community as a whole. Hence, there is no need for the artificial and arrogant orders and inducements excogitated by individual people to create the strength needed for this purpose. All these orders should be abolished particularly since they add artificial impediments to the obstacles to be surmounted when following the laws of nature.

However, the second factor adduced for the commission of these errors does not provide sufficient reason for their retention. There can be no doubt on this score. We know that the individual does not obtain his satisfactions in life at the expense of the overall population, but that he does much more for the community than – in the latter's opinion – he obtains. According to his own estimate, however, the exact opposite holds true so that he does not face the community as such with hostile intent but only in connection with, and in the totality of, his satisfactions in life. But he can only enhance these satisfactions if no limits are imposed upon his freedom of production.

The Restoration of Property

By Hilaire Belloc

1936

Man, to live, must transform his environment from a state in which it is less to a state in which it is more useful to himself. This process is called «The Production of Wealth.»

Moreover, if a man is to live conformably to his nature, there must be available for his consumption a certain amount of wealth, in a certain variety, for a certain unit of time. For instance, in our society, he must have so much bread, so much meat, so much of a number of different foods every day, so much beer or wine or spirits (or, if he be too weak to consume these) so much tea or coffee or what not; a sufficient amount of somewhat complicated clothing, all to last over such and such an amount of time; and a sufficiency of fuel, housing and all the rest of it, also to last a certain time.

Now this transformation of environment called «The Production of Wealth» is obviously only possible through the use of the instruments of production. A family can only live conformably to its human nature (that is, without undue suffering) in a given civilization on condition that it receive securely and constantly so much of this varied wealth for its consumption. But the wealth can only come into existence through the manipulating of natural forces by certain instruments; and there must also be an existing store of food and clothing and housing and the rest of it so that human beings may carry on during the process of production. These stores of wealth, these instruments and these natural forces are the Means of Production.

It is obvious that whoever controls the means of production controls the supply of wealth. If, therefore, the means for the production of that wealth which a family needs are in the control of others than the family, the family will be dependent upon those others; it will not be economically free.

The family is ideally free when it fully controls all the means necessary for the production of such wealth as it should consume for normal living.

But such an ideal is inhuman and, therefore, not to be fixedly attained, because man is a social animal. It is not impossible of achievement for a short time, and has been briefly

achieved whenever a lonely settler has fixed himself with his family and his stores in an isolated spot. But such complete economic freedom for each family cannot be permanent, because the family increases and divides into further numerous families, forming a larger community. Moreover, even were the isolated free family to endure, it would fall below the requirements of human nature, its isolation stunting and degrading it. For men cannot fulfil themselves save through a diversity of interests and ideas. Multiplicity is essential to life, and man to be truly human must be social.

Society being necessary to man, there arise in the economic field these two limitations to economic freedom:—

First, *Difference of Occupation*: Each in a society will concentrate upon what he has the best opportunity for producing and, by exchanging his surplus of it for that which another has the best opportunity of producing, will increase the wealth of all: or what comes to the same thing, lessen the burden of labour for all. Thus men live more happily in an agricultural village if there be a miller to grind the wheat instead of every family grinding it under its own roof, a cobbler to mend and make the boots — and so on.

Second, a *Principle of Unity*: There must exist in some form the State. A sufficiently large unit for the development of the arts and the better complexities of life must be organised. Its power must be appealed to for the satisfaction of justice, the prevention of internal disorder and for the arrangement of defence against external aggression. In general the State must exercise some restraint upon the ideal economic freedom of the family or freedom itself cannot be guaranteed.

But, while difference of occupation restricts the ideal independence of the family, it does not destroy freedom until one or another differentiated (and necessary) occupation can withhold its necessary function and thus impose its will. If the miller can refuse to supply flour to the rest, who have lost their instruments and aptitude for grinding wheat, he will be their master. So with the unifying authority of the State. If the State can cut off livelihood from the family it is their master, and freedom has disappeared.

Therefore, there is a test of the limit after which such restriction of freedom is hostile to our aims and that test lies in the power of the family to re-act against that which limits its freedom. There must be a human relation between the family and those forces which, whether through the division of labour or the action of the State, restrict the family's liberty of choice in action. The family must have not only power to complain against arbitrary control external to it, but power to make its complaint effective.

It has been found in practice (that is, it is discoverable through history) that economic freedom thus somewhat limited satisfies the nature of man, and at the basis of it is the control of the means of production by the family unit. For though the family exchange its surplus, or even all its production, for the surplus of others, yet it retains its freedom, so long as the social structure, made up of families similarly free, exercises its effect through customs and laws consonant to its spirit: the guild; a jealous watch against, and destruction of, monopoly; the safeguarding of inheritance, especially the inheritance of small patrimonies. The freehold miller, in such a society as was ours not so long ago, though he had no arable or pasture, was a free man. The yeoman, though he got his flour from the miller, was a free man.

The name for a control of the Means of Production is «Property». When that control is exercised severally by individual units we call it «Private Property» to distinguish it from property vested in public bodies. When so great a number of families in the State possess Private Property in a sufficient amount as to give its colour to the whole, we speak of «widely distributed property».

It has been found in practice, and the truth is witnessed to by the instincts in all of us, that such widely distributed property as a condition of freedom is necessary to the normal satisfaction of human nature. In its absence, general culture ultimately fails and so certainly does citizenship. The cells of the body politic are atrophied and the mass of men have not even, at last, an opinion of their own, but are moulded by the few who retain ownership of

land and endowments and reserves. So essential is property to full life, though it is debatable whether a full life is to be aimed at. There may be some who dislike freedom for themselves. There are certainly many who dislike it for others. But, at any rate, freedom involves property.

To-day in England, and to a less degree in many other countries, widespread property has been lost. Ownership is not a general feature of our society, determining its character. On the contrary, absence of ownership, dependence on a precarious wage at the will of others is the general feature of our society and determines its character.

The family does not possess that freedom which is necessary for its full moral health and that of the State of which it is the unit. Hence, our society has fallen into the diseased condition known as «Industrial Capitalism». In this state, the control of the Means of Production is vested in a comparatively small number; consequently economic freedom has ceased to be the note, giving its tone to society.

«Capitalism» does not mean a state of society in which capital has been accumulated, its accumulation protected, and itself put to use in producing wealth. Capital so accumulated, protected and used must exist in any human society whatsoever, including, of course, a Communist one. Nor does «Capitalism» mean a state of society in which capital is owned as private property by the citizens. On the contrary, such a society of free owners is the opposite of Capitalism as the word is here used. I use the term «Capitalism» here to mean a state of society in which a minority control the means of production, leaving the mass of the citizens dispossessed. Such a dispossessed body of citizens is called a «Proletariat».

Industrial Capitalism has in its present phase other grave evils attached to it besides the loss of freedom, for the twin evils of Insecurity and Insufficiency are attached to it. The main body of citizens, the Proletariat, are not sufficiently clothed, housed and fed, and even their insufficient supply is unstable. They live in a perpetual anxiety.

Now those two evils of insecurity and insufficiency might be eliminated and yet economic freedom be absent from the mass of society.

There are two ways in which they could be eliminated without the restoration of freedom: —

The first way is through that which I have called elsewhere «The Servile State». In this form of society, the minority controlling the means of production supports all the vast majority of the dispossessed, even those whom it does not use in exploitation, and thus forms a stable society though one from which freedom is eliminated. That is the direction in which we are drifting to-day. The capitalists keep men alive by exploiting them at a wage, and when they cannot do this, still keep them alive in idleness by some small subsidy.

The second way is Communism — of its nature unstable but practicable at a heavy strain though, presumably, for only a comparatively short space of time. Under this second system the means of production are controlled by the officers of the State, who are the masters of all the workers (slaves of the State), and the wealth produced is distributed, at the discretion of the State officials, among the families, or, if an attempt be made to abolish even the family, then among the individuals of the community.

There is a third form of society, and it is the only one in which sufficiency and security can be combined with freedom, and that form is a society in which property is well distributed and so large a proportion of the families in the State severally own and therefore control the means of production as to determine the general tone of society; making it neither Capitalist nor Communist, but Proprietary. If, then, we regard economic freedom as a good, our object must be thus to restore property. We must seek political and economic reforms which shall tend to distribute property more and more widely until the owners of sufficient Means of Production (land or capital or both) are numerous enough to determine the character of society.

The Formation of Capital and Wealth and Its Consequences for a Free Economic Order

Hans Willgerodt

1979

In the discussion which has hitherto taken place in West Germany on savings and wealth formation, the issue which stands out as being of prime importance is the problem of how to achieve a more even spread of the country's assets. Many people have expressed the view that capital resources are being concentrated in fewer and fewer hands. With this in mind, the marxists have been predicting that the West German market economy is gradually becoming ripe for socialization and nationalization. This gave them a welcome starting point for class warfare since, due to a continuous rise in the real income of the mass of the population, differences in income are no longer a popular theme for censure.

However, the marxists did not wish to curtail the concentration of wealth which they criticized but, instead, to carry it to extremes. In their rejection of an equitable policy designed to promote capital formation, they often found themselves in the same boat as the supporters of laissez-faire. The general public has availed itself on a wide scale of the offered schemes for saving and accumulating wealth, even though these programmes were in part very unsophisticated and indeed still are. In the meantime, the concentration of the nation's assets has decreased so that we can continue to hope that the problem will lose some of its acuteness if we pursue our traditional policy – subject to a number of requisite adjustments from time to time.

On the other hand, the structure of our capital resources is not satisfactory and I, for one, do not believe that the alterations which have taken place will suffice. The situation proves unsatisfactory, because risk capital is not available in sufficient quantities and because the general public avoids this form of investment for a number of very different reasons. Moreover, encouragement has been given for some time now to the latest tendencies towards disparaging the formation of capital and wealth as such i. e. irrespective of the problem of redistributing the country's assets. Both trends may become critical for economic and social

development. The growth of trade and industry depends to a large extent on the willingness to provide risk capital. In addition, a naive unconcern about the capital problem can result in an erosion of reserves and the consequences of that are incalculable.

I shall try to treat the hazards of consuming our reserves in a wider context although attention will primarily be focused on the depletion of capital, the failure to form new capital and the misallocation of capital. The consequences for economic policy arise from the necessity to connect patterns of behaviour which, in my view, are dangerous. Moreover, the direction in which such a policy should move can be clearly identified, even though we have not been able to work out a detailed programme.

The frequent cases of indifference towards discernible yet slowly growing cancerous developments, which may be overlapped by positive influences, spring from many different sources. There are still a great many optimists in our affluent society who believe that it suffices to place a ruler along the line of development to date in order to be able to venture the assertion that we are now firmly on the path leading to the «post-industrial society». There is no need to spend any more time on considering supplies of industrial goods and the necessary capital resources under this theory. The only possible worry would be the lack of demand occasionally afflicting the «affluent society». The land of Cockaigne is now in sight, at least as far as industrial output is concerned; consequently, it is considered necessary that the service-rendering trades should account for a larger share of the GNP. At the cost of great effort and research, experts have frowningly ascertained that in this respect West Germany still has not yet reached the international norm – whatever that may mean.

Now, there can be no objections to any expansion in such services if they are in real demand among consumers. In part, at least, the higher share of the GNP accounted for by the services sector in other countries conceals a certain amount of unemployment in the public sector with the population being smothered in a network of superfluous regulations and provisions. Such a service-rendering bureaucracy can easily lose contact with the agricultural and industrial basis of its existence.

At all events, sufficient real capital must be formed either in order to penetrate by means of economic growth into the sector where additional income is used on a decreasing scale for industrial goods, or else because industry must have sufficient productive capacity to be able to carry the host of less productive labour forced in the service trades. It should also be noted that a substantial and constantly rising amount of real capital has become necessary for part of the services sector.

Hence, the avenue leading to the service-rendering society of the future will have to be paved with more and better capital. And, broadly speaking, more and better capital can only come from a growing economy – which will also be able to bear the burden of environmental control and many other things more easily.

However, economic growth has meanwhile begun to attract a rising volume of distrust. Even good economic performance and the demand for it have come to be suspicious. All worries about future times when such performances might be useful are left to the State and to the funds of public authorities and the social security system, who nurture the illusion by means of constantly increasing redirection of funds that it is possible to live permanently from hand to mouth. The formation of capital is being neglected more and more and almost seems superfluous.

The main priority remains the volume of our present consumption and the socio-political guarantee that it will continue so – a consumption, moreover, which does not require any efforts on one's own part. Social policy is now marked more and more by the claim to passive benefits and exemption from all duties except that of paying regular contributions. Active participation and a direct individual contribution are deemed «unsocial», even among those perfectly able to render services. If we take «social» to mean the money and strength of other people, then this description may be relevant. This passive attitude now seems to be

spreading to the cultural sector where active participation such as reading a book for oneself seems to be out of fashion – even among students.

We could become a nation of non-participants, merely linked together by our obligation to pay taxes and insurance contributions. The implication for the economy might well be that we would abandon the habit of thinking in terms of passing on assets from one generation to another. Under such a philosophy, the individual is merely supposed to give thought to the present; the «collective» will look after the future.

The Trend towards Depleting our Economic Reserves

If we take a look at West Germany's recent economic, social and financial policy, there is no overlooking the fact that the tendency to dip into reserves has increased even if there is no reason for dramatization and, when compared with other nations, our country comes out as a «relative sinner» only. Nevertheless, we do draw uncovered bills on the future and postpone problems to later dates when they will be more difficult to resolve.

An example which I would like to cite because it stands out in its scale and distinctive characteristics is the statutory scheme for retirement pensions. Since 1957, this has been financed out of apportioned funds derived from the regular income of the employed members of the population and from tax proceeds. In return, contributors to the statutory insurance scheme receive the pledge that they will later be looked after in the same way as the present generation of pensioners. This expenditure-covering procedure and the renunciation of any attempt at capital formation for funding retirement pensions were hailed at the time as a brilliant idea: An excellent provision was said to have been made for the future and this was even to be index-linked with pensions increasing in line with expanding gross wages and salaries. All capital and asset formation for the purpose of financing retirement pensions was deemed superfluous and even harmful; it was said to rest on an economic fallacy.

The proponents of the new system of completely financing the expenditure for social security by simultaneous contributions expatiated in great detail on this supposed error. Any objections and wishes for corrective adjustments simply failed to get a hearing. Nevertheless, the adherents of the above «total reallocation system» have so far been unable to adduce any economic proof of their theses. What they have offered by way of evidence will not stand up to precise examination. Following a somewhat ambiguous observation by *Mackenroth*, it was for instance asserted that capital, once formed, could not be reconverted into social expenditure i. e. into consumer goods. In order to discredit completely the formation of capital as a means of providing for the future, it was added for the benefit of the unenlightened that all welfare expenditure must always be raised from the national income of the current period. Recourse to assets accumulated during the past was not possible. For that reason, no amount of twisting and turning could get round the need to cover expenditure by means of adjustable contributions if pensioners were to be properly looked after.

How was it possible for such assertions to gain acceptance and dissemination over a period of several decades without anyone really scrutinizing their scientific foundations or without anyone consulting the elementary facts of capital theory which, in themselves, would have refuted the arguments? Real capital is in fact constantly being consumed, liquidated and converted into consumer goods. There is no absolute necessity for written-off amounts always to be reinvested. That also holds in macroeconomic terms, even though this does not imply that the economic consumption of capital is a desirable thing.

Mackenroth himself conceded the possibility of cutting the investment ratio in favour of consumption and welfare expenditure. But how can extension investment possibly be distinguished from replacement investment? At the same time *Mackenroth* rejected any cut in the formation of capital. Why? For redistributive purposes, he aspired to a large national product and, with this in mind, declared the consumption of capital to be undesirable. But in

so doing, he admitted that the present-day formation of capital enhances the future GNP, thus widening the possibility of earmarking sums from it for welfare purposes, including the payment of retirement pensions. As a result, today's accumulating of capital serves to pay for tomorrow's old-age pensions. That holds true irrespective of whether problems arise in regard to the liquidating of real capital and whether the mouse-trap theory of capital formation is correct or not.

Mackenroth's unclear theses were readily misconstrued when his followers set out to cut the link between capital accumulation and provision for old age and to force through the sole claim of expenditure-covering by simultaneous contributions as much as possible. Nevertheless, the pension insurance funds had accumulated certain assets under the phased cover procedure (with contributions fixed for a ten-year phase so as to cover outgoings during that phase). When the pension insurance funds recently stumbled into a crisis, it was soon ascertained that these assets could easily be liquefied. The assets were offered on the capital market where they attracted savings, which could then be used for financing pensioners' consumption expenditure.

Following this more or less cosmetic operation and further emergency measures, the crisis afflicting the pension insurance funds now seems to have been temporarily overcome. When the baby-boom generation reaches the age of employment, larger contributions will be forthcoming. If the number of children remains small, the outlay by the working population will not grow excessively and those at work will be able to afford additional insurance contributions and taxes.

No social policy-maker will fail to seize this opportunity for expansion. The pensions will be substantially raised and – a more important consideration – the move towards the social welfare State will be made irreversible in other respects, too. As a result, growing sums of money will be made available for immediate consuming. It is improbable that anyone will think of the possible alternative of investing more and accumulating capital in order to supplement the dwindling number of children and consequent reduction in the labour force as a production factor by means of another production factor i. e. real capital.

In consequence, the fundamental crisis looming ahead for the pension insurance funds is certain to accelerate. In view of the population trends, the burden of retirement provision will expand significantly because the working population available to finance it is decreasing. The greater the additional promises made to future pensioners, the more the crisis will be brought forward and heightened. Every promise of higher pensions not only furnishes further opportunities for consumption, but also implies higher insurance contributions. These higher charges cannot fail to impair the capacity of the working generation to save and amass capital. If the burden of contributions needed to finance pensions rises to the predicted level of about 30% of gross wages, the resistance to such rates may well jeopardize the much-lauded «contract between the generations». That holds all the more true in that the multitude of calculations hitherto made point to a further enlargement of the scale of public provision so that insurance contributions and tax payments are certain to rise. Even now, the Minister of Labour is casting around, in his straits, for further and more pliable sources of money such as the value-added tax.

In addition to that, inaccurate arguments in favour of small-business and trade are sometimes deployed in order to facilitate political action. It is pointed out that small and medium-sized enterprises are more labour-intensive and therefore have to bear a greater load of social insurance. But this chain of reasoning overlooks the argument that the machinery in capital-intensive firms is partly financed by the insurance contributions of their suppliers, that the interest and dividend paid are not capable of further diminution and that the remaining net product liable to payment of the value-added tax also constitutes the labour income even in capital-intensive enterprises. Akin to this forgetfulness was the resistance offered by small business to the introduction of the value-added tax, because they felt – rightly or wrongly – that this would hit them particularly hard. The only really manifest

feature to emerge from all these plans is that the idea of accumulating capital does not attract much popularity.

One might well turn a blind eye to all these trends if the potential number of employable persons from whom the contributions are to come could be stabilized and employed with a growing degree of productivity. Yet, here again, we can observe a process of eroding reserves which, instead of being curbed, has actually been actively encouraged by many (including the Government itself). True, the causes of the sharp decline in the birth-rate are multifarious in nature and not exclusively political in origin. The economic grounds and motives often quoted do not suffice in my opinion, and in some cases they are downright irrelevant. At any rate, there is no mistaking the presence of that fundamentally anti-bourgeois emancipatory propaganda which is now so ubiquitous and which refuses to accept any of the social rules. Its adherents speak of «liberalization», thus misusing the good reputation of classical liberalism for the goals of social chaos. An alarming decline has taken place in the sense of normal values: for example that a marriage should be for a lifetime and for bringing children into the world and that their mother should be available for them, however advanced her views may be.

It is against this background that we should view the reform of the law on abortion and its various concomitants. This reform would at least have been more credible if it had not been accompanied by an attempt to depict abortions to the general public as everyday matters capable of expeditious treatment upon production of a sick-certificate rather than the human tragedies which they are in reality. People possess enough instinct to know better than to put more children into this brave new world of ours.

What economic consequences will falling birth-rates produce? Can large and rising birth-rates in themselves constitute an economic advantage? The answer to the second question must be a clear-cut «no». Mere births in themselves simply signify in economic terms the existence of more consumers and, by implication, fewer resources for other purposes such as accumulating capital. The newly born only become a production factor capable, *inter alia*, of being burdened with pension insurance contributions after a fairly long and expensive process of educating them. In other words, children must first reach the stage of adult volition and cognition fundamental to production. The education imparted to men and women is sometimes spoken of as human capital. The experience gathered after the devastations of war has shown that this is the most important of all forms of capital and that the replacement of physical assets often proves possible with the aid of human resources within an astonishingly short space of time.

If we look at the matter more closely, it appears that people's capacity for production rests on a certain sort of capital formation. Human and physical capital together guarantee our future national product and funds for our welfare expenditure.

In other words, the expenditure-covering method of simultaneous and adjustable contributions used in social welfare insurance is based in the final analysis on the past accumulation of capital assets. The dogmatic proponents of this expenditure-covering formula must face up to this complete reversal of the basic thesis, i. e. their proposition that the accumulation of capital does not serve to safeguard the future. It may take you aback to see people simply regarded as a vehicle for amassing the requisite capital resources. However, the given economic circumstances do not permit any other interpretation – irrespective of what economic system may be in operation.

The quarrel between those desirous of leaving provision for old age entirely to the simultaneous expenditure-covering process and those keen to see the formation of physical assets also exercise a function is therefore in the final analysis a dispute about what kind of capital formation will be more suitable for the future.

It seems logical to assume that the supporters of simultaneous adjustable contributions will make every effort to improve education and training in such a manner as to ensure that as productive a type of worker as possible is formed, because they are the ones who will have to

carry the onus of social welfare contributions. In point of fact, the growth of expenditures for education in West Germany is quite remarkable. At the same time, the experts on our educational system have voiced considerable misgivings about the situation. The outlandish fashions in pedagogy, organization and administration currently besetting our schools and universities have on the whole tended to cut productivity. A large segment of the disbursements lavished on education has been squandered in economic terms and, moreover, without even achieving any cultural benefits.

This expenditure serves to promote progress-minded and emancipatory trends and, not least, to advance emancipation from the control of the tax-payer. All of this is accompanied by propaganda indicating the clearly negative attitude taken to hard work and exacting demands. Hardly anybody has the courage to voice a few home truths and to point out that the people who feel most overburdened in their activities are those who have not regularly practised application and effort. Systematic education is often replaced by a kind of gratuitous educational consumption at the expense of the State, i. e. a concealed form of unemployment. Naturally, parents have voiced the demand for functional tuition since they, after all, are the ones who have to provide for their children and make sure that all the expense is not wasted. As a result, the «progressive» educationalists try to break parental resistance and to exploit the State's monopoly in schooling for ideological purposes. Even though these may remain tendencies which are never completely successful, they do nevertheless indicate with manifest clarity the direction in which education has erred.

If fewer children are being born, it seems logical that the authorities should make it somehow clear to childless persons that provision for their old age cannot be guaranteed in macroeconomic terms simply by the payment of social insurance contributions, which are then immediately used for consumption purposes. Childless persons ought to be induced to play a more substantial role by forming either human or physical capital.

Instead of this, however, the problem is usually construed as a matter of equalizing the given burdens. Parents are to be enabled to achieve the same standards of consumption as childless persons and thus to offset their putative disadvantage. In this case, the childless persons' capacity to save is curtailed in order to increase parental consumption. However, this achieves nothing towards strengthening our economic future. A more correct course of action would have been to force childless persons to increase their level of savings instead of encumbering them with higher insurance contributions, which then immediately go towards consumption. Whilst parents are forming human capital, childless persons should at least accumulate physical capital so as to supply the children of the others with tools and to enable them to work more productively and to pay insurance contributions more readily also in favour of childless persons. Inasmuch as such physical capital is not used up in the course of pension payments to childless persons, it will devolve upon the children of other persons through inheritance and bring about a productive equalization of family burdens instead of one based on consumption. At the present time, however, no thought has been given to the creation of reserves for the future.

The opponents of an accumulation of capital and savings designed to safeguard the future believe that everything depends on achieving a labour potential of adequate size and quality. If that were true, there would still remain the problem of how to put this potential to its most expedient use. The manner in which the problem is being tackled at the present time reveals a mentality of nonchalance such as seems to be universal nowadays. The cyclical downturn is seen to be generating unemployment, and the direct policy conclusions drawn from this phenomenon are based on Keynesian recipes, which can legitimately only be applied for short periods but are misused as concepts for long periods.

According to this theory, the problem does not consist in employing as large and productive a labour potential as rationally as possible, but in cutting the allegedly superfluous labour potential to the bone. Those politicians who reckon with substantial economic growth when pensions are assessed or raised and who wish to accomplish this growth at all

costs – even at the price of budgetary deficits and inflation – nevertheless proceed from the assumption that the productive potential appears to be too large. Such persons are deluded by the old fallacy of economically fixed amounts of work, which tempts them into computing in minute detail how many jobs industry and trade will provide in the course of the Eighties. This number is compared with the growth in the labour force ensuing from the baby-boom years so that the inevitable result will be a certain measure of unemployment. If we had been alarmed by such calculations at the time when the West German economy was still being managed by *Ludwig Erhard*, we might well have felt constrained to close the borders with East Germany from the Western side and thus to save those bricklayers in the East the bother of building the Wall. As we all know, the influx into the West German labour market was much larger than the temporary rush of job-seekers in the years marked by heavy birth-rates. At some point of time, we are going to have to make up our minds about whether, in economic terms, too many children or too few children have been born. It makes no sense to be in favour of population growth when concerned with old age provisions, the family and population policy whilst rejecting a growing labour force when concerned with the labour market.

The problem of unemployment must be taken very seriously. In order to overcome it or to appear to have overcome it, we can either proceed along the path of restriction and erosion of reserves (as frequently proposed) or the path of expansion and capital accumulation. We can quickly name the measures which will prove necessary if we take the first path of consumption. These are first of all the irreversible cuts in normal working time and the introduction of earlier retirement age, restrictions on pensioners working, preventing persons from pursuing two occupations or spare-time jobs, lengthening compulsory school and training attendance while lowering the level of occupational requirements; and hindering (or preventing) rationalization investments. However, earlier retirement places a heavier burden on the pension insurance funds and public finances for consumption purposes. The same applies to longer periods of school attendance inasmuch as they are not productive. It also holds true of the brilliant proposal about substantially increasing the size of the civil service in order to provide more jobs! All these proposals have been submitted for serious consideration.

The other course of action consists in not merely embellishing unemployment by cosmetic means, but effectively eliminating it. There is no need at this point to go into the large number of feasible measures, some of which have already been tried out. Social policy in particular often proves to be an obstacle to employment if the Government thereby greatly enhances the risk of new appointments for firms by enacting provisions somewhat similar to those in the new law on divorce.

Needless to say, the new entrants to the labour market from the baby-boom generation will demand at least the same wages as hitherto customary. The older employees will urge that there should be no slowing of the rise in wage-rates, even if more German workers are temporarily available. The only solution will be for the new recruits to the workforce to be equipped so profusely with modern capital that they can achieve at least the level of productivity of the old workmen. In other words, more physical assets must be created so as to guard against unemployment.

Capital Requirements

The question naturally arises as to who will be willing to effect the additional investment needed to employ a larger labour force at as unchanged a degree of rising productivity as possible. I have no wish to minimize the importance of this issue. It is, in part, a serious problem. But is there really any shortage of investment and savings at the present time? Is not the current problem really one of directing the sustained flow of savings into the right

channels? Is the worry about the adequacy of capital reserves still justifiable? The present cyclical upswing has revealed an unusual propensity in trade and industry to invest, with seemingly adequate financing facilities. Here, again, it would be easy to deem a temporary situation to be permanent and to lose sight of the long-term problems. My own prediction is that the future will be marked by much greater capital requirements than those of today: hopefully, my prognosis will be refuted! Apart from the necessity of making the labour potential more productive and equipping it with continuously modernized physical capital, large amounts of physical assets which have forfeited their value as a result of technical progress and international competition will have to be written off. Unfortunately, a large slice of new capital resources will have to serve for defending the present standard of living against influences likely to lead to a comparative loss of affluence. These negative influences emanate above all from the uncertainty surrounding energy supplies and their rise in price. In order to offset this influence, a high volume of investment will be inevitable – even when a policy of saving energy is to be pursued. The question arises as to what is taking place in the minds of those who squander lots of petrol, while demonstrating against any measure to be taken and against the requisite investments to be carried out and for the maintenance of the present energy-wasting technology.

But there are other losses of affluence, which can be offset by a more vigorous amassing of capital assets. Inasmuch as environmental deterioration has been observed and steps taken to arrest this trend, that merely signifies an attempt to rectify a relative loss of wealth. A similar situation applies when national defence and civil protection call for higher expenditure in order to retain the previous degree of external security. It will also be necessary to continue to grant development aid with part of the sums lent being immediately written off.

Many of these responsibilities devolve upon the public authorities. Is the State prepared for these tasks? To begin with, it suffers from a certain degree of internal disorganization and lack of real direction within its own ranks – and I speak from experience as civil servant. Quite apart from that, the State's level of indebtedness is becoming a growing problem. Some of the borrowing of recent years was no doubt cyclically unavoidable. Naturally, the volume of debts could have been kept smaller if private investment had not been delayed, hindered or rendered unprofitable by means of a surfeit of legal measures. Moreover, the deficit in the Government's budget has not only served – as the Keynesian doctrine prescribes – to finance state investment to replace the partly cancelled private capital expenditure, but it has also flowed back into state consumption in some cases. In the meantime, the state deficit remains formally classified among governmental investments. But one would have to examine precisely what is to be written off as misinvestment among governmental investments and what is actually to be recorded as consumption, for instance a newly built canal (Elbe-Seiten-Kanal).

Be that as it may, the State is now approaching future investments in a condition of substantial indebtedness with a mountain of exaggerated taxes and levies as an inheritance of yesterday's over-optimistic reforms. In a certain sense, the State has virtually no reserves. The real implications of this may be discerned from the following. If the Government were not so much in debt, it could borrow with an easier mind the sums required to finance its investment expenditure and projects. If the burden of taxes and levies had not grown so much because of the State's manifold activities, there would still be scope for financing additional public expenditure without incurring the taxpayers' wrath so much as at the present time. The State is not in an enviable position.

Even if public borrowing takes place for investment and «productive purposes», it nevertheless entails special problems although these are partly unavoidable. To the individual citizen, governmental bonds appear to be private property without any obligation to record them as debts, to pay interest on them and to redeem them in full at a later date. Instead, it is the State which must deduct appropriate amounts from the tax revenue and this can easily lead to immobility in public budgeting. If the State has not created any tangible

assets with the borrowed sums, they only represent fictitious assets in macroeconomic terms and they must be treated pursuant to the simultaneous expenditure-covering formula. The most hazardous reallocation process in this context is inflation, which occurs without the participation of the State, but which then accords with public interests when the level of indebtedness grows.

If the State is to assume new functions, it must rationalize and terminate its less urgent activities. The procurement by the Government of sufficient capital for environmental protection purposes, for example, presupposes the existence of a healthy private sector which invests on a sufficient scale and forms the reserves needed by the economy as a whole. However, the necessary investment does not come about unless sufficient risk capital is available. Although there exists a great demand for such capital, it is not being satisfied because of the numerous checks and hindrances. Why are so few or almost no new independent joint-stock companies established? Why are parcels of stocks and shares practically never opened up so as to serve as the basis for new issues of securities? Why are capital increases effected much less frequently than they were in the Fifties?

The concentration of the equity capital of industry and trade (fallaciously known as productive capital) has occasioned vigorous complaints about the unfairness of our market-economy. In part, this criticism is certainly unfair. Yet there are sufficient employees who could set up in business for themselves or purchase shares. Why do they refrain from this more often than necessary? As the yield on shares indicates, the purchase of equity can still not be recommended to the general public as a form of investment—despite the reform of the corporation tax. Enterprises will have to alter their dividend habits (and that is perfectly feasible). If they need more capital resources, they will have to issue new shares. The fiscal and other constraints on such a move still abound on a wide scale.

As regards small and medium-sized enterprises, employee participation in equity capital still faces many legal and practical difficulties. What is lacking is simply the political will to overcome the undeniable difficulties which persist even at the cost of accepting some problems of delimitation in the tax laws.

A fear still prevails of the «small-scale capitalist», who might in this way become alienated from his class interests. Only collective funds receive mercy at the hands of the critics, as the gap between investors and enterprises is sufficiently large to curb the emergence of any close feelings of partnership.

Furthermore, our social policy has accustomed everyone to believe that the assumption of risks is not a matter for him personally, but for some government cash office. It is small wonder that this also spreads to the sphere of capital formation and distribution. The most popular concept at the present time is insuring oneself against insolvency so as to get the best of both worlds, either by firms founding a «fire-brigade-fund» and compensating such shareholders for losses as fall within appropriate social provisions or else by the State coming to their rescue. The traditional view was, however, that an entrepreneur should at least be responsible for the prosperity of his firm so that insurance against the inefficiency of business undertakings would be tantamount to a fire-insurance policy with a clause permitting arson.

The concentrating of business in ever larger and diversified enterprises allows, by means of internal compensation of losses by profits, to hedge against the assumption of individual investment risks. This method is, however, the wrong way and it leads in the final instance to the end of a market economy. In the Soviet Union, all profits and losses are offset against each other within the ambit of public finances and it requires laborious efforts to find out which of the factory managers is individually responsible.

The following train of thought may be useful in bringing the overall economic implications of the problem into sharper focus. In a growing economy marked by technological advancement, free choice of consumption and open frontiers, the productive process is subject to risks which can be spread but not eliminated. If wage-earners wish to be exempt from such risks as far as possible, there must be sufficient capital resources and entrepreneur-

rial capital to absorb the disadvantages inherent in the inevitable changes. However, the buffers of the economy, e. g. the owners of equity capital expect a certain remuneration for their willingness to face hazards and to «tremble for the fate of their firm». The smaller the number of persons and investors willing to make their income dependent on personal success, the larger will be the per capita income of those willing to shoulder this risk. If the due remuneration is refused – as in the case of shares – then this form of investment is eschewed.

However, it is beneficial for social policy to have an abundance of risk capital. Machines do not need any protection against dismissal; and capital accepts changes more readily than human beings. In other words, more capital means more social security. But capital resources must be available in the special form of risk capital in order to guard against losses to earned income. Those who resort to various legal devices in order to protect risk capital against liability must pass on the losses to someone else such as employees or the State, who then of course quite rightly assert their right to a say.

Conclusions

What conclusions can we derive from this for a sound economic policy? There is still a need for an active policy of encouraging savings and capital formation in order to spread personal wealth as widely as possible. In addition, it is becoming more and more important to observe carefully the structure of total capital assets plus reserves and to reduce the inhibitions which militate against the dispersion of equity capital. No support should be given to the idea of collective funds into which compulsory contributions have to be paid and whose assets are directed pursuant to different objectives than those of contributors. Nor would these be advisable in economic terms due to the setting-off of profits and losses.

The economic problem of capital formation viewed as provision for future needs must be freed from the ideological blockade which the proponents of the simultaneous expenditure-covering formula imposed against it. I trust the reader will not misunderstand me on this point: I have no wish to see the fundamental guarantees now reached converted into a capital-covering procedure. I know how impossible that is. But we are talking about the future. Those without any wish to form human capital or to raise and educate children ought to be induced to contribute more towards physical capital. This may be achieved in many ways. Under a market economy, it is best done by debiting such persons for the cost of their retirement pensions, i. e. they will obtain a smaller pension entitlement for the same contributions. That accords with market-economy philosophy whereby people must first help in forming the means of production before laying claim to benefits. (Contributions paid under the simultaneous expenditure covering system do not represent sufficient provision for the future. In macroeconomic terms, they only mean that income earned in the present is redistributed; by no means do they imply that the future of the individual contributor is secured. The situation changes as soon as physical or human capital are formed. Redistribution in the past causes no economic values to stream into the future even if this redistribution or «solidarity» is legally enforced and substantiates a microeconomic claim of the contributor.) These persons' pensions could be made up to the desired norm in the private sector with the stipulation being made that this category of men and women must take out life-insurance cover. I would add that I have conducted a correspondence with the father of the concept of indexed-linked pensions, *Wilfried Schreiber*, and ascertained that we are in full agreement on the following fundamental point. Once that the basic guarantees for old-age provision have been established by means of the simultaneous expenditure-covering procedure (with contributions adjusted annually), the way ahead is then clear for supplementing pensions by private contributions. No scope should be left for according widowers' or widows' pensions to childless persons unless they pay separate contributions.

The State must put its own house in order and bid farewell to the old view that it must never surrender responsibilities once they have been assumed. We know examples of such reforms from the days of Ludwig Erhard and we can now see an illustration in Great Britain, where the foreign exchange controls which Keynes recommended so much have now been abandoned without any replacement after 40 years. The experts who were engaged in implementing these controls will certainly find sufficient jobs waiting for them in the foreign exchange market!

Finally, there is absolutely no reason for us to indulge in a zealous consumption of our reserves in line with the Keynesian maxim that everything simply depends on demand. I am no misanthropist who is basically against consumption and working shorter hours. Let there be no misunderstanding. What is produced can be consumed. But today's prevalent habit of only consuming and not thinking about how production will hold up in the long run is a matter which I see as a danger to our economy. It is not just present demand and consumption which are important – as some people point out when arguing that we shall in any case all be dead in the long run. On the other hand, capital formation and a free market economy can be elastic enough to master our future problems.

Chapter III

The Interdependence of the Various Systems

Social Irenics

Alfred Müller-Armack

1950

The Possibility of Establishing a Social Concept embracing different Creeds and Ideologies

If at some time in the future an attempt were to be made to determine in retrospect what had dominated human life in our time in terms not so much of the great wars and discord between nations and political parties as of the more profound aims of mankind, nothing could be more gratifying than for the present period to be regarded as an age of reconciliation. In saying this, are we merely expressing a hope that has been engendered in us by a reality that is so totally different? Or is there not already an attitude forming in the deeper strata of European life which represents an attempt to overcome the existing differences and which sees in the dissolution the essence of preservation and in those differences the elements of a possible unity? Those who seek to explore the nature of our epoch will have difficulty in finding a quality of unity in it. They will be all too inclined to deduce from the discord it displays on the surface an internal chaos. But this is contradicted by signs of an enigmatic self-assertion of the mind and spirit of this age, a more liberal and a more distinct emergence from a general sense of being threatened, and it is contradicted moreover by our scientific work in those areas where it is advancing to new solutions, where we are beginning to speak for ourselves. Our age has indeed long since embarked on roads that belie its outward circumstances.

Certainly, those external circumstances are conducive to that impression. After the convulsions of two world wars, it seems perfectly natural to be calling for reconciliation. But what is the point of cherishing such a hope if it does not come from within, if we are not aware of the things which we have in common over and above the divisions between us?

Our situation can be compared to that of the late seventeenth century. The Thirty Years' War left Germany in much the same condition as at present. The positions of the churches

and territorial boundaries had changed somewhat, but on the whole they had become permanent. All parties developed in their own peculiar way: Catholicism with its baroque culture and theology; Lutherism with its piety; and Calvinism engrossed in the task of strengthening its inner sectarian formation – gaining fresh impetus around 1700. But this period of consolidation had been preceded in the decades following the conclusion of religious peace by what must be termed the real «irenical» epoch in our cultural history. Attempts were made to reconcile religious and ideological precepts, to identify common ground and to nourish the hope of regaining the lost unity in faith. These aspirations were symbolised by the efforts of Leibnitz, Spinoza, Bossuet and Molanus to establish peace between the Churches. The mediatory theology of Helmstedt University and Calixtus was the theological expression of the circumspect comparison by another school of learning such as comparative political science of what had hitherto only been perceived as hostile religious differences. The difficulty of agreeing on matters of dogma was of course soon realized, but the resulting irenical attitude was passed on to the 18th century and did much to generate confidence in the harmony of the universal order and in the reconciliatory task of the world of philosophy and theology.

Can we hope for something similar, indeed more effective, in our age? After the First World War, *Max Scheler* observed in 1926 that we were now in an age of conciliation. He saw the old antagonisms between the nations, the sexes and the political parties disappearing and believed he detected a process in which the adversaries were increasingly absorbing each other's main characteristics and in this way easing the tensions between them. But if we judge from our present-day experience, these expectations have not been borne out.

When we consider the situation in Europe on this side of the Iron Curtain, i. e. the area where free intellectual and religious contacts are still possible, we must surely reach the conclusion that the spiritual forces which determined and still are determining the fate of the European nations have established a stable balance both there and in the European overseas territories. Basically, there are four groups which hold the balance: Catholics, Protestants, evolutionist Socialist, and Liberals. Our scientists have not been treated as a separate group in this context. In the 19th century, they were closely linked with the advance of liberal ideas, but today they form part of the general basis of all ideological groups.

Although we have just stated that the position of these four groups appears quite stable – so that there is little prospect of one ever being able to oust another – this runs contrary to the expectations of the groups themselves. Marxist socialism still hopes to bring about a Socialist Age, and eminent scholars with no Marxist background such as *Joseph Schumpeter* are convinced that this hope of a Socialist Age will come true.

Times of undisputed advancement by one particular group lead to such over-estimation as with Catholicism in recent decades. It has long since made up for the 19th century lack of European literature about Catholic values and concepts. Germany and France as well as Britain and Italy are experiencing a wave of renewal in art, literature, philosophy and theology which is influencing the young generation in particular. Protestantism has nothing comparable to offer. It is uncertain of itself and cannot present such brilliant artists and writers as *Claudel*, *Maritain*, *Bernanos*, etc. The conversion of such distinguished Protestants as *Sigrid Undset*, *Reinhold Schneider*, *Gertrud von le Fort*, and *T. S. Eliot* also exercised some influence, but this should not be over-rated. On the other hand, none of the Catholic countries today exercise any political influence.

And however uncertain of itself Protestantism may otherwise be – a situation on which even *Karl Barth's* work has had little effect – it has nevertheless reached the height of its political effectiveness. The effort to save the Western world is clearly being led by the Calvinist-influenced powers, the United States and the British Empire. The philosophy behind the large-scale relief programmes for Europe cannot be understood without the long Calvinist-Lutheran traditions in which Western democracy is rooted. How small by comparison is the contribution of France, Spain, Italy, Ireland or Austria. If we wish to

make a realistic assessment, we must see the current spiritual strength of Catholicism against the background of the actual supremacy of the mainly Calvinist countries, whose spiritual influence is to be seen more in terms of international politics.

In relation to these Christian forces, Marxist socialism occupies a very powerful position in all countries. That position is, however, weakened by the confrontation with Eastern Europe, which insists that it is the champion of true Marxism. It possesses factual power, but cannot call on the unbroken strength of a totally consolidated ideology.

Liberalism's situation is completely different. It has long since forfeited its widespread influence. Its political parties have everywhere become insignificant splinter groups. Whether the recent successes of such parties in Germany and Austria will change this situation is still uncertain. Nevertheless, liberalism must be considered the fourth power which, with socialism, is influential in those sections of the society where secularization is increasing. Its political and economic ideas have emerged more clearly from the disappointments which the world suffered as a result of totalitarianism and central planning. Thus, neoliberalism has experienced a spiritual renaissance, not as an isolated group but as a principle which once again strongly pervaded all other groups. The results of modern sociology and political economy encouraged this development.

Broadly speaking, there emerges a unique social situation with each group forming part of a stratum which, depending on their strength, they can fully or partly permeate without any hope of being able to determine overall the situation as it exists today. Philosophical and theological influence is held in check by political impotence, political strength by philosophical and theological uncertainty, and lack of influence externally by identification with currently advancing scientific ideas. If we assess the situation correctly, none of these positions is likely to be forced out of the race or to become the solely dominating element. We shall have to accept that the co-existence of these elements of power is what is shaping the ideological countenance of Europe. Similarly, we shall have to consider what responsibility falls to each of these positions by virtue of this co-existence between their irrepressible spiritual and ideological power.

Although these polarities cannot be eliminated from the social life of today, they do not of course make up the complete picture of our spiritual situation. The latter is also influenced by a process of clarification designed to explore more deeply the specific and lasting features of each denomination. Protestant theologians, chiefly the Swiss *Karl Barth* and *Emil Brunner*, and the Germans *W. Althaus*, *Elert*, *Iwand*, *Stauffer*, *Thielicke* and others, are presenting a more fundamental picture of the origins of the evangelical concepts than their predecessors in the 19th century, from *Schleiermacher* to *Harnack*, because of the influence of the Romantic movements during their period. Similarly, Catholic theologians, such as *Schmaus* and *Guardini*, have re-appraised the roots of Catholic comprehension. And it is no different with liberalism, which is no longer content with the superficially formulated arguments of the 19th century. By drawing on the works of *Lord Acton*, writers such as *von Mises*, *Böhm*, *Einaudi*, *Eucken*, *Hayek* and *Röpke* paved the way for a more in-depth substantiation of the liberal ideal. Socialist theory, too, has progressed beyond the stage of mere Marxist exegesis and built a better foundation with the aid of redefined concepts. This tendency to reflect on the special characteristics of one's own position has in some cases made dividing lines more distinct than hitherto, but at the same led to a dialogue in which each participant, starting from the security of its own position, found it possible to pose the question as to the common and uniting features with less inhibition than in the past. The unity of the Christian faith within the ambit of the *Una Sancta* movement is discussed among the denominations on a deeper foundation than in the 17th century. The Anglican High Church and Catholicism cultivate their links with the Church in Eastern Europe. The ecumenical movement has made the Protestant factions more conscious of their common interests. Socialism has overcome much of its free-thinking traditions and begun to review its relationship with the Churches. An intellectual exchange has also developed between

socialism and liberalism with the latter learning to define its social aims more precisely and the former seeking to bring elements of liberal philosophy to bear, principally in its economic policy.

In the first wave of enthusiasm resulting from this dialogue, the possibilities of softening the painful rigidity of division were often over-rated. All those concerned overlooked the fact that they had prepared their approach after consolidating their basic position so that, even though they were able to trace the distinctions and adopt a fairer attitude to one another, little or nothing could be achieved about removing the actual barriers. We have outstanding examples of this in the research on the Reformation by the Catholic religious historian Lortz and in the works of *Franz Schnabel* on German 19th century history. There was also an approximation of positions as between liberalism and socialism in the field of economic policy. Otto Hoffmann rightly observed that both in the United States and Germany, liberal and socialist economists had surprisingly moved closer together. But the general situation was such that none of the four groups could be induced to abandon its position. Thus, our only hope of eventual unity lies in irenics, a kind of reconciliation which accepts the existing divisions as facts but without giving up the attempt to find the common basis for unity. There is little chance of this hope being fulfilled as regards ideological, not to mention theological positions. Yet the aim of an irenical rapprochement is important if we relate it to the practical universal task of social development with which all four are concerned.

It seems that the time has come to consider from the irenical point of view how far it is possible to lead present-day ideological positions together in pursuit of a common objective. Such a reflection, starting from a possible common foundation, ensures that we do not follow the path of a mistaken concept of irenics: the belief that all other standpoints can be eliminated by discussion, or that of a false scepticism whereby all theological positions seem unimportant; and then proceed to advocate a vague combination of them all. An irenical reflection is today only possible on the basis of accepted positions. Today more than ever before, it is time to ponder possible common ground beyond those established positions. The aim must be to emphasize what may have been agreed just as much as what remains the cause of division. A common framework would benefit all, but it can only be created if the contribution each side can make and if the positions each must forgo are clearly stated.

Let us therefore examine each of the four groups in the light of their irenical reconciliation.

Catholic Social Doctrine

Catholic social doctrine has a more solid foundation when it is compared with the fluent Protestant, the brittle socialist, and the open liberal one. The understanding of the personal value of man derived from his God-like image affords Christian social doctrine a secure common foundation from which it can assess such worldly values as property and society without ever considering them overvalued – a danger to which secularized viewpoints may easily be prone. To the extent that general Christian concepts suffice, Catholic social doctrine acquires in addition a superior breadth through the *Ordo* concept. This concept, which was fully developed by the profound scholasticism of *Thomas Aquinas*, possesses significance for current thinking on social theory in the fact that it gradually brings our day-to-day civilization into line with God's eternal ideas for the conduct of human life. I realize that I shall be contradicting certain Protestant convictions when I say that this is the essential contribution which Catholicism should render towards the irenical unity of modern social theory – the comprehensive *Ordo* concept – thus giving that theory the firm structure it so badly needs. After a century of decline in which society has switched from one doctrine to another and in which there has been a dangerous tendency to regard secular values as absolute both in the social and political life of the community, it is now a question of

establishing timeless values. These must be sufficiently superior to our earthly designs that they will prevent us from seeing earthly values as absolute, yet concrete enough to serve as guides for our earthly actions. The efforts to derive an overall Christian culture based on Western spiritual values will have to be oriented to this aim. Protestantism has nothing comparable. Those of its supporters who hopefully cling to the idea of a general Christian civilization in spite of its rejection by some Protestant theologians have this very concept in mind when they think of a Christian Occident and the «system of Creation». It is a concept which has been developed in Catholic social theory as a common Christian doctrine.

It is no coincidence in the latest liberal economic theory that the *Ordo* concept was chosen as the title for the yearbook embracing the joint work on these problems. The attempt to present the economy as a natural order, for instance by *Röpke*, points in the same direction. None of the other groups has the innate capacity to establish for the building of the future social structure the comprehensive Christian foundation which has long since been developed by Catholic social theory. Protestant social theory will likewise be able to adopt this foundation as an element in an overall Christian faith. At least I see no serious theological objections to the recognition of the concept of the personality and of *Ordo* as a common Christian basis of social theory.

The contribution by the Christian Churches will consist for the most part in the basic principles of our social order. As regards the concrete aspects of the historical approach and of the technical task of resolving the problem, there still persists a rivalry between the liberal and social ideas which flowed from the secularized spirit of the 19th century. The advocates of those ideas enjoy the advantage that they are more directly linked with present-day society than the Churches, whose social doctrines have their origins far back in history.

If we are serious about working for an irenical rapprochement, Catholic social theory itself whilst adhering firmly to its fundamental concept will of course have to be aware of the special historical circumstances from which it has grown. At the same time, there are limits to its influence in a world which is largely dominated by Protestant countries. Here, one must recal in particular the roots of the Catholic Church in the estates of the realm. Since the early Middle Ages, the Catholic Church has acted as a corporate counterweight to State, Emperor and King. And, as I have attempted to show in greater detail elsewhere, it was intertwined with the ramified class structure of the Middle Ages embracing the clergy, the aristocracy, the free landowners and cities. Basically, this class structure (which safeguarded the status of farmers and craftsmen and tied them to the Church) was retained until the end of the 17th century in Austria, Spain and Italy and in the free cities of the German Empire such as Cologne, which remained Catholic. It is these corporate roots in Catholic countries that have to this day stimulated the guardians of Catholic social theory to propagate the concept of a social structure which, though modernized, is cast in the mould of the corporate system of the past. I need only recal in this context the system advocated by the Jesuit priest, Father *Pesch*. The social theory propounded by the *Spann* circle in Vienna was greatly influenced by these views and also inspired by the Romantic movement of the time. More recent social experiments such as systems of the kind advocated in Germany and France, whereby workers can enjoy a share of their firm's profits, point in the same direction. It is not my intention to consider whether such corporate ideas are right or wrong. But if we wish to establish an irenical unity of social theories, we must be clear in our minds that this historical foundation is peculiar to the Catholic countries. In the Protestant countries, the old class structure has lost its foundation – gradually and hesitantly under Lutherism, quickly and radically under Calvinism. The aristocracy, city freedom, corporate loyalties and the prerogatives of the clergy were removed so that the words of the French Revolution: «Il n'y a que l'Etat et les individus» not only formulated a demand but a reality which had long been established in Protestant countries. In these countries, corporate thinking no longer has any real force of conviction; and none at all in the new emerging social classes of trade and industry.

If the Protestants were to accept without qualification the superiority of the *Ordo* concept, it would be all the more necessary for Catholic theorists to discard the social concepts handed down by the Catholic countries in which they originated in favour of a design embracing the whole of Europe. Precisely because of the intermingling of denominational areas as a result of the flow of refugees in recent years, this status acquired in the other «denominational zones» must be taken into account when fashioning the social order. Otherwise, the system would not meet pan-European requirements, quite apart from the fact that it is utopian to believe that a Catholic-type solution in the old style has any chance of being accepted in the Protestant countries.

The moral values which must govern the social system have been established both for the Catholic Church and for Christianity in general. Thus, they cannot in themselves be made the subject of an irenical reconciliation. It is different with regard to the concrete expression of social theory, the proposals put forward here and now, and especially the methods and techniques of social protection. Whilst the main principles have already been laid down, the area of relative historical validity is open and the conceptual system must from the outset be capable of absorbing new experience and progressive research. It seems as if Catholic social theory – and Protestant social theory, too, for that matter – has identified itself all too closely with contemporary views which are at least questioned by scholars, if not actually dismissed altogether. The wish of the Churches to discharge their social responsibilities compelled them to examine such concepts as «capitalism» and «socialism». They then found themselves forced into an alternative position based on certain prevalent attitudes, particularly the view that social protection is best achieved by constraint rather than by those methods once specifically proposed by liberal thinkers and currently experiencing a spiritual revival. It is no less erroneous in my view to expect religious theory to advocate the use of liberal methods in the pursuit of social policy. But it does seem necessary to reserve, as it were, an area of Christian social theory where scientific philosophy can find its rightful place, and to avoid any identification with specific techniques and social safeguards. True, the papal encyclicals have opted for a well-balanced system between freedom and constraints. However, it should not be forgotten that very often on social issues the fact that theologians of both denominations have had little training in the handling of economic and sociological problems in itself leads them to yield to the *opinio communis*, which in our time states that social protection can only be achieved by the application of anti-market-economy methods. This involves the Churches in technical problems which they should be spared. In the past year, we have witnessed with misgiving how the advocates of a now disintegrating authoritarian economy have been making a last desperate appeal to the clergy of all denominations to support their mistaken economic policy. The clergymen have to some extent responded. During the last six months prior to the Currency Reform, there were calls from the pulpit for consumers to exercise self-discipline, for hoarders to sell their goods, but no admonition to those who, contrary to all reason, imposed the wrong kind of economic system on the community. The termination of that system has revealed the errors that were perpetrated.

Hence, if we think in terms of an irenical solution, we are bound to come to the conclusion that, whilst acknowledging the firmness of the Catholic approach, social theory can only be moulded into one single entity if it goes hand in hand with the development of liberal sociological and economic research. In recent decades, economic theory has conceived the principle of free competition as being of social benefit to the community. It is important that Catholic social theory should now adopt the same approach without hurriedly taking up the principle of economic control.

There is another pitfall in Catholic social theory, which calls for brief mention. I have tried elsewhere to prove that it is not Catholic social theory itself but the tendency to introduce radical social concepts into Catholic education which stems from the unique construction of a social utopia. The inclination towards a social system in isolation can still be observed, for instance in the considerable degree of attention which Catholic groups concerned with social

problems give to the question of employee profit-sharing. Here again, I feel it is necessary to see the social problem as one which relates to the economic system as a whole and to the Western industrial countries in general, and then to apply principles of a fundamental nature which can be comprehensively developed. That is better than submitting proposals which, however sensible they may be, represent only partial solutions and easily deceive us into believing they offer more than they actually do.

Protestant Social Ethics

The fact that an analogous system of Protestant social ethics, definable in terms of a specific entity, does not really exist may be viewed as a disadvantage or else as an advantage. Whereas Catholic social philosophy and social policy have been formulated in concrete terms in a number of important works, Protestant social theory still stands in the early stage of development. This incipient approach is still totally unknown outside the circle of those specializing in this subject, and in any case the experts often disagree among themselves. It is not that the central theme is any less distinct, but it does not form part of a world order conceived as a single entity.

The possibilities of co-operation along irenic lines have to be assessed differently, depending on the trends in Protestant ideas. The most manifest feature today is the reform movement represented in the main by *Karl Barth* and strongly supported by many theologians of the «Confessing Church» in Germany. Intensive theological reflection has produced the image of a church divested of its power and reluctant to adopt any definite position on the concrete shaping of world affairs. Judging by the ungodliness and sinfulness of this world, any attempt to invest it with a man-made social order would seem a forlorn venture. There seems to be no path leading from that situation to irenic co-operation in the establishment of a social order based on a sense of Western responsibility. Concepts of the kind used in Western Christian countries or in conventional Christian policies are immediately dismissed as meaningless. As a result, the verdict reached by this group also applies to those parties dedicated to a political leadership which is inspired by a Christian spirit, irrespective of how they meet this requirement. It is not the fact that they do not fully attain the chosen goal which is held against them, but that they set one in the first place. Owing to their fundamental rejection of the world, this group negates every attempt to move in the direction of a Western Christian order or even to establish some measure of identity with the Catholic standpoint. Strangely enough, however, they have few inhibitions about contacts with the left, as demonstrated by Barth's comments on the Hungarian Reformists. They are antibourgeois and opposed to «political reactionaries», but fail to see that these terms are now mere clichés.

How large this group really is, I will not venture to guess. But it exists and there seems little prospect of engaging them in an irenic dialogue. Yet they are not omnipotent, since there is another movement embracing many strata including in particular Lutherans, the United Protestants and members of the Reformed Church. They are most anxious to resolve the problem of the social order in a spirit of Christian responsibility.

What *Luther* added to the Catholic social structure, which – like so much else – he had adopted, constituted an important supplement. It was above all his deeper concern for an individual's vocation which, especially in Germany, imparted a greater moral dimension to the fulfilment of one's chosen profession to an extent hardly equalled in other countries. Luther's other occasional observations on the social structure do not make up a complete system. They were, as even Sombart noted, the views of a man who had little knowledge of any of the modern institutions with which even the schoolmen had been familiar. The danger of transferring too much responsibility to the State and thus of placing too much confidence in a system of social control was greater than under Catholic social theory which, on account

of its universal dimension, was protected against the temptation to embrace the absolute State. Whereas in the case of Catholic social theory the solidity of the *Ordo* concept often left little room for the absorption of new ideas, the danger inherent in Lutherism is that of too close an identification with the State.

Notwithstanding the central themes of faith and dogma, I see no reason in respect of shaping the social order why the Christian social theory as developed on a highly scholastic level should not also be accepted as valid for Protestantism. That does not preclude certain shifts of emphasis in the substantiation of this theory. The concept of the human personality and of a divine system of creation are common to both, the work of the charitable organizations a universal Christian commandment. The fluidity of Protestant social ethics may afford a basis for irenical unity as the medium of mutual endeavour in influencing the development of the world. Naturally, such a loose structure would offer little resistance to the incorporation of new research findings.

One should not conclude from this that Protestantism's contribution to the building of the social order is a negligible one. This may be true of the constructive aspect, the elements which leave their impression on the scholars. But let us not forget that Protestantism has not usually derived much of its influence from the organizational side and that it does nevertheless influence developments in the world. Its immense historical contribution towards the development of modern social systems is for the most part overlooked. Owing to the abundance of recent patterns for social policy, one has almost forgotten the many social reforms which stemmed from the various sects of the Reformed Church and from the pietist Lutherism of the 17th and 18th and early 19th century. This characteristic feature and this sense of social responsibility existed, even where secularization became the dominant trend, and it is to be hoped that they will be conducive to co-operation as a whole.

Socialist Theory

Marxist movements today exercise the greatest conceivable influence in nearly all countries, but their philosophy belies their outward appearance. Their intellectual stance has become uncertain and, as they admit, it is going through a process of complete readjustment. This was necessary not only on account of the distinction vis-à-vis Bolshevism, which after all is the purest form of Marxism, but to a greater extent because of the serious crisis which Marxist theory has been experiencing for some time. We must at long last take a serious look at the points made by the critics. They maintain that the phases of capitalist evolution described by *Marx* were incorrect. More recently, they have attacked the anthropological philosophy which he developed from ideological doctrine and which, after all, enjoyed the backing of the Darwinists. If Marxism is to survive as a serious socialist doctrine, it must be brought into harmony with the more recent tenets of economic theory, human anthropology, contemporary forms of society and the function of cognition and modern science. Some progressive socialists are undergoing this process, but it has by no means spread to the socialist parties as a whole. Those who are not prepared to admit that *Marx*, despite his great ideas, was to a very large degree committed to the outdated ideological principles of the 19th century are rendering a poor service to the cause of socialism, for the fragility of its foundations is apparent in the very character of the movement.

The socialist movement will not be able to join in any irenic unity among the great social theories unless it can free itself from its traditional anti-clerical approach, which is really a fortuitous legacy of the 19th century. One should ponder without anxiety to abandon certain old-fashioned initial characteristics. Liberalism stands in no different a position to socialism in this respect. If it wishes to form an intellectual union with the great social theories, liberalism will have to discard the secular elements inherent in much of its doctrine. True, socialism has already dropped its free thinking to the extent that it tolerates the Church

much more than in the past. But it is still a long way from there to full acceptance of the fact that the foundation of our Weltanschauung cannot be some kind of secularized substitute religion and that faith is indispensable to the Christian way of life. But this path can and should be followed. Incompatible with Christian doctrine is the type of socialism which serves as an idolising surrogate, as it were, for an abandoned faith. The Christian is from the very outset forbidden to believe in man's self-redemption through some kind of social amelioration.

That is not to say that socialism cannot render a valuable contribution to the discussion of social issues. It takes the same stand as Christian doctrine in its criticism of unsocial conditions. Social welfare as an expression of Christian philosophy was almost a prerogative of the Church in its campaign for religious renewal throughout the Middle Ages, and the contribution to social criticism by Protestant sects in particular was no less important. We do not wish to overlook the fact that, although this aid for the needy provided by the Catholic charitable organization «Caritas» and the Protestant «Innere Mission» was continued in the 19th century, the problems created by the growth of industry demanded sharper criticism and more radical means than were offered by the Churches. It may be to the credit of socialism that it has adopted a blunter approach to the problems attendant upon modern social development, and there is no reason why this criticism should not receive serious consideration in an irenical dialogue. There is one qualification, however. When viewed from the Christian standpoint, this criticism cannot go so far as to recognize classes in conflict with one another as the ultimate ratio of human society.

Of course, society has meanwhile progressed much further and new problems have arisen towards which socialism has adopted much the same conservative attitude as one might accuse the Churches of having had in the 19th century. Its attempt to see the cause of the working man's loss of individuality and isolation in nationalized industries and state intervention and in the growth of a uniform, machine-dominated civilization has meanwhile become questionable. Apart from the transformation of its central theory, Marxist socialism is undoubtedly having to reconsider the instruments at its command. The anti-market policy it has pursued for decades, the systematic paralysis of private initiative and its insensitivity to local characteristics and peculiarities have thrust it into a critical phase ever since it was found that the system of central economic control had not only economic but also serious social flaws and that these could only be remedied by abandoning such methods altogether. What proved harmful to socialism was the fact that it retained from its past a mythical philosophy which saw capitalism, imperialism and socialism as historical realities and even considered them capable of self-development. And one also perceives in the works of such progressive socialist theoreticians as Lerner and Lange (and their latest ally Schumpeter) an economic rationalism which, whether its economic calculations are right or not, fails to appreciate that sociological developments in the «socialist century» followed paths quite different from those they had expected and promised to their followers. Burnham's book «The Régime of Managers», whether correct in detail or not, seems irrefutable on one point: central socialist economic management places power in the hands of one group and is thus wholly inconsistent with socialism's image of freedom and equality. It is not much use socialism invoking supposed laws of development to support its position. Such mandatory development will last only as long as people are willing to move in the prescribed direction. There has been little hope of this being translated into reality for some time now – indeed ever since the true nature of a centrally planned economy was revealed as a total contrast to its image and thus providing little to attract the broad masses of the population.

But unless all the signs are deceptive, socialism is about to undergo such an inner transformation. If it does so resolutely, there is no reason why its social impulses and its assessment of the dangers inherent in the modern work process should not combine with the efforts to achieve a social irenical system.

Although liberalism has not exercised any mass appeal for several decades, I think it would be a mistake to ignore it. In former times, it undoubtedly held the strong position of a fourth ideology and, after all, the development of the world's economy in the 19th century rested for the most part on its vision of the future and its technical principles. At the present time, liberalism consists primarily of a group of influential educational philosophers, economists, sociologists, historians, writers and politicians – probably a few hundred all told. Its influence is an intellectual and literary phenomenon which owes its special significance to the failures of those political structures and economic methods which were the upshot of an antiliberal approach. The situation is much the same as in Britain, where the Liberal Party was crushed between the Labour Party and the Conservatives but where the influence of liberal ideas in the big parties remains greater than ever before. One observes a renaissance of liberal principles which, willy nilly, are at present holding sway in international discussions on economic and social issues. The new liberalism has a different and more profound message than in the 19th century. Its advocates are at pains to detach it from the historical circumstances of the past and to develop a new position of social responsibility.

Let us begin with the question as to how far this liberalism can reconcile its position with that of the Christian Churches. It should be pointed out that this new liberalism takes a much more dispassionate view of itself; its self-image is that of a purposeful social and economic organization. It has thus shed all those general ideological ambitions which characterized it in the 19th century. The process of inner clarification has advanced much further than in the case of Marxism. The adherents of Christianity must make sure not to confuse the image of that ideological liberalism of the 19th century (from which Catholic theologians but also those of the Reformed Church strongly dissociated themselves) with the highly sophisticated and instrumental views held by the liberalism of today. There were liberals of this category, even in the 19th century, who discerned an inseparable bond existing between Christian and Liberal concepts. *Lord Acton*, for instance, once wrote that religious freedom is the creative principle underlying civil liberty, and civil liberty the necessary condition for the religions. He also observed that the true magnitude of man exists only in the harmony of his liberal and his religious feelings. Such words reveal an attitude which makes this great English historian and champion of personal freedom a really outstanding irenical figure, standing as he does between the major social movements.

Liberalism, we must admit, emerged from a process of secularization. But as Acton himself never tired of saying, the true democracy of freedom stems from the Christian faith. For him, «freedom without faith is a freedom that has been deprived of a good part of its substance». In that process of secularization, liberalism has continued to conserve many Christian moral values. Today, we are inclined to be less antagonistic towards its relationship with Christianity than in the 19th century, in much the same way that we now see modern science more closely linked with the currents of natural philosophy of the late Middle Ages.

Thus in an irenical dialogue, it should not prove difficult for the new liberals – if they have not already embarked on this course – to concede the peculiarity of their position and to reserve within themselves that space which can only be filled with Christian faith. Even in this form, liberalism would still largely be seen as what it wants to be: a more profound analysis of the instruments available to us in our efforts to master social problems. This is clearly where it can develop its special significance, and it will be important for Christian social theory and for socialism to incorporate the liberal concepts thus accepted as valid, since the value of this «Fourth Power» lies primarily in the progressiveness of its instrumental thinking. It stands for a liberal social approach and hence for a section of society which looks beyond the eternal guiding principles of faith and social compassion and which

provides us with concrete methods and instruments. These grow in usefulness, the more that we appreciate their significance and we should employ them to translate our philosophical concepts into reality.

Conclusions

If we consider the irenical opportunities afforded by the social movements of today, the result may seem quite promising. Of course, there still exist obstacles by virtue of the fact that many of these movements claim to possess ultimate validity. But the path towards a genuine reconciliation which does not detract from the dignity of these ultimate issues and which does not hamper our acquisition of knowledge has not been barred. This possibility becomes more realistic, the more the differing philosophies are clarified and reshaped. In an age critical of substitute ideologies which have been quickly knocked together and which have proliferated in the past hundred years, socialist and liberal social doctrines are becoming increasingly aware of the limited scope of their central theme. This matter has not yet been finally clarified, but a beginning has been made and there is fertile ground for an irenical dialogue. The truce which can be achieved will of course not be possible by means of a simple decision to merge all the different positions simply because each of them has the well-being of mankind at heart. The real need is for a critical exploration in order properly to assess what contribution each can make. The moral aims of socialism, the *Ordo* concept of Catholicism, the inspiration of the vocational concept and the fraternal help offered by Protestantism can achieve a great deal if they are combined with the modern organizational principles inherent in the new liberalism. Each philosophy must surrender part of its traditional thinking.

Only on the basis of such a common social concept can a genuine European social order grow and thrive. No single force can claim for itself the huge area that has to be covered. Each is too heavily bound to its basic principles for that. But there are common transcending elements which can be identified and linked together. This is a field of practical work for the Churches. How far they will ever be led together in faith we do not know. Considering the present state of the world, it seems unlikely that, even if agreement were achieved on the crucial dogmatic issues, it could ever be put into effect on account of the thousandfold ramifications of existing doctrine. But we can at least make a start in a practical sense. Following our experience with the dissolution of a world that has become increasingly secularized, we must set out to eliminate this danger and to form a society based on social security and freedom.

The following is an attempt to give the bare outlines of such an irenical solution, but it should be treated with every reserve. It ought not be a solution in which the will for social readjustment will flag or, worse still, turn into a defence of the conventional forms of social welfare. On the contrary, our starting-point must be the inadequacy of the positions which we have held up to now and the absolute necessity of solving the social crisis of a modern society whose deep-seated causes are apparent to us from the appraisals carried out by contemporary theologians. We would be taking too shallow a view if we were content to ascribe everything to class warfare and ignore that deep process of spiritual decline which has been taking place for two hundred years and which constitutes the ultimate cause of the depersonalization of labour and the sense of isolation in modern man, the disintegration of family ties, the advance of National Socialism, etc. Since the present social problems call for a much deeper diagnosis, the range of possible remedies will have to be much broader than those hitherto applied within the framework of a socialist system concerned solely with the allocation of the national product. The present social crisis cannot be localized. It is a disease of a very fundamental nature. Obviously, this much wider criticism of the nature and extent

of our social distress must go hand in hand with an equally critical attitude towards the principles of social reform hitherto applied. It lies in the very nature of Christian faith to oppose from the outset the concept of any possible social self-redemption and with it the construction of a social Utopia. There will be concurrence on this point, too, following the miserable failure of attempts to reshape society at the roots. But we must also appreciate the need for a change in social policy in everyday practice. The principles of social welfare applied up to now, which have paralysed individual initiative and undermined private ownership (including that of small and medium-sized enterprises) have been dubious and in need of revision. The Churches have always emphasized the necessity for a restructuring of ownership based on rights and duties. Of course, that will require exact statutory codification. Legal experts have already made the preparations; all that is necessary is to give concrete shape to the principles adopted.

In a dialogue aimed at increasing public awareness, I will not suggest from the vantage point of an instrumental liberalism that the proposal put forward by myself and in similar form by other supporters of market economy principles is the ultimate solution. But an irenical approach does, after all, imply an approximation of different points of view and the abandonment of that autarky which has sometimes caused the would-be participants to stand in the way of their own proposals. The more liberalism openly acknowledges the special nature of its own doctrine and fully accepts the social criticism of socialism as its own concern, and the more it appreciates the need for diagnosing the problems of our time within the full ambit of the Christian view of the world, the more it will see itself obliged to adapt the instruments of a social policy based on the free-market system to the other standpoints and to identify the available opportunities in a mutual dialogue. It concerns the once more apparent opportunity to transform the market economy (which is in fact a many-sided organizational instrument) into a «social market economy». I have attempted elsewhere to explain the nature of such a social market economy, which is by no means synonymous with simply reliance on the greater productivity of a free organization. On the contrary, any free system requires appropriate safeguards to give it the form consistent with present-day moral convictions. In this case, too, thinking in irenical terms means being able to see the problems from different perspectives, to be aware of the essential objectives and to be familiar with the technical principles on whose basis social aims can be more realistically achieved. How often have social policies merely accomplished apparent success! But now we have the perception which enables us to pursue our social aims with more effective instruments. True, there are also dangers in this instrumental approach. But precisely because Christian principles make us conscious of the depth of human social misery, we refuse to see the ultimate objective in any form of state intervention, whether it be distribution, nationalization, or full employment. What we were able to assume from the first Christian approaches has often been re-affirmed by experience. All of these avenues are only partial solutions to the overall problem, which nobody is more capable of mastering than someone who, from the very beginning, knows that the available resources are inadequate and who does not overestimate them.

A shrewd advocate of the new order recently termed it the «natural social order». We are in full agreement with this if «natural» signifies that directness, humanity and concreteness of solution necessary to overcome the abstract, impersonal form of social protection from which we have long suffered. As we have meanwhile established, this naturalness is not an easy gift in a secularized society which always gives preference to the unnatural, the abstract and the impersonal. It is a system which embraces human nature in its entirety.

I have attempted to examine conflicting social theories in the light of harmonizing them. Such unity can be brought about. We cannot achieve it without a greater effort, of course. Today, every faction is faced with the task of overcoming its ideological isolation and of regarding the concerns of the others as its own. The future will not belong to those autarkic systems built solely on their own principles, but to those which take the attitudes of others

into consideration. It is our conviction that such an irenical effort is possible in spite of all the outward antagonisms and without any side having to abandon its fundamental principles. The fronts will remain. But if at least the creation of a social order can be seen as a common task, then that in itself will mean a lot for the unity of our civilization.

Left-Wing and Right-Wing Approaches to the Market Economy

Franz Böhm

1953

An article has recently been published under the title «A Market Economy of the Left?» («Marktwirtschaft von Links?») in which it is asserted that there can be no such thing as a «left-wing», or a «right-wing» market economy: there can simply be a market economy, full stop. One might be inclined to agree with this assertion if one had in mind, not any actual market economy which has existed, or exists, in the real world, but rather a model of a pure or perfect market economy. Both the reality of such a concept simply cannot be admitted, for the following reasons:

When one tries to imagine a pure or perfect market economy one finds that it must be based on a particular distribution of income, which can only take account of those who, in one way or another, participate in the productive process, whether as owners of land or capital, or as entrepreneurs (carrying out economic plans at their own risk), or as workers. This distribution of income through markets has the sole purpose of directing economic goods, and the services of entrepreneurs, technicians, and organisers, to where they are most needed. (As to where goods and services are most needed, this is decided, according to market principles, by the entirety of consumers through their daily individual decisions about what to demand, the effects of which emerge publicly in the form of market prices). Because the production process in a market economy depends on the voluntary, independent plans of the individuals taking part, a motive force is needed to act on individuals so that they shape their individual plans in accordance with the demands of their fellow participants in the economy, and so combine with one another in a rational process of labour and production which transcends the individuals themselves.

In the real world there is a very large number of people who do not contribute to the economic process of the market economy: children, housewives, the old, the sick and infirm – (apart from the unemployed whom, for the moment, we shall disregard). All these people receive no income from the market process. In addition to these large groups of people, there are others who perform necessary or useful work but who, nevertheless, receive no income through the market, being remunerated in a different way: for example, officials, teachers and public employees.

All these people have to be maintained out of the incomes of those who take part in the productive process. For these people, the market economy makes no direct provision and can make no direct provision. The obligation to provide for them rests partly on their families, and also, to an ever growing extent, on the community and the state. It arises from the constitution of the market economy itself that the task of providing incomes for those who are not directly remunerated through the market should come to fall increasingly on the community and the state, and that, therefore, this task passes increasingly to political bodies. As contrasted with the self-sufficient household or feudal economy, the market economy is not well suited to the fulfillment of distributional responsibilities through the family, the church, or private charity; it cannot readily accommodate the intervention of these particular kinds of distributive agency. It is, therefore, political and not economic processes which, to an important degree, decide what quota of the incomes earned in the market is to be transferred to those groups who are not directly remunerated through markets, and as to how these transfers shall be distributed between particular individuals and categories.

Transfers of income have further consequences. Through transfers, incomes are distributed to many more individuals than they are through purely market processes. Moreover, this occurs in a way which can be anticipated by the recipients of non-market incomes, who are provided with purchasing-power and thus take part in the decisions regarding consumption, saving, and hoarding, which guide production and the sectoral and temporal structures of industry.

The wider distribution of incomes makes possible the general participation in the education and political life of a free society, while for broad classes of the population standards of culture and consciousness can be achieved which a purely market economy does not bring about. In this way a large reservoir of highly qualified workers and entrepreneurs may be made available to the market economy. The market economy may, to some extent, be supported and supplemented by, or via, the incomes of the non-market sector. But the existence of this supplementary sector creates problems in spite of the fact that it may improve, to some extent, the performance of the market economy: for in other respects it endangers or threatens the market economy.

Providing for and maintaining this supplementary sector, insofar as this is not done by the family, is a political task. But the scope for political intervention is certainly limited, if a necessary regard is to be observed for the regulative functions of the market economy; though a significant political scope remains. The idea that the structure of a market economy inherently comprehends, in itself, a complete political and social order fails to recognize that the instruments of such an economy are limited to the guidance of production, and possess only a technical role within an overriding political and social division of functions and responsibilities. The immense significance is also overlooked of this overall division of responsibilities for the technical functioning of the market economic order. On the other hand, there is the contrasting notion, according to which intervention in the market system of distribution, and decisions regarding the overall political and social division of functions and responsibilities, need have no regard to the autonomous working of the market economy. This is to overlook the mutual interdependence between the economic order and the distribution of income, as well as between the specifically market and specifically

political aspects of the economic order. The political «right» tends to make the first of the two above-mentioned mistakes and the political «left» the second. The political «right» is inclined to assume that the market economy necessarily reacts undesirably and unhealthily to political intervention; while the «left» assumes that the market economy is robust enough to absorb any interventionist mishandling, or to digest any foreign bodies which are fed into it.

It is clear, therefore, that insofar as the political «right» or «left» recognize or uphold the functions of the market economy there is plenty of scope for a full range of «right-wing» or «left-wing» political attitudes. The slogan «A Market Economy of the Left» is by no means confused, or absurd, or erroneous theoretically, but contains much significance and sense. A society which upholds a market economy can contain parties with differing economic, social, and political views. Arguments and conflicts between political parties which recognize the functions of the market economy are absolutely necessary. They can contribute significantly to improving the understanding, and to refining the functioning, of the market economy, within the overall economic and social order. For those devoted to the Holy Grail of pure market economy are no less one-sided and blind than those devoted to the Holy Grail of «Socialism», who concentrate their attention on the framework of economic data described as «the legal and social order», and from this altitude look down with contempt on such humdrum questions as those of the institutional regulation of the market mechanism.

Here are the sources of the serious errors which handicap the operation of the market economy to-day. Two most important problems remain unsolved. One is the problem of the aggregate instability of the market economy, which is decisively related to the problem of the monetary framework. The second problem is that of monopolies and interference by interest groups, the nature of which stems from the fact that those engaged in economic activity, either as individuals or in groups (combining the pursuit of group interests), rebel against the imposition by markets of the need constantly to adapt to changing circumstances and changing tasks, and against the heavy uncertainties thus imposed. There is a refusal to recognize that the bearing of these risks and uncertainties is an essential element in the freedom of movement and freedom to plan which the market economy provides for those taking part in the production process, and especially for entrepreneurs. Every producer wants to have his cake and eat it. He wants to limit his uncertainties and, at the same time, retain his freedom. He wants to ensure a place for his rigidly preserved vested interests within a market economy of which the first principle is mobility and strict obedience to the market. Instead of producing in accordance with effective demand, he wants to force demand to take what is produced, and, at the same time, to preserve the right for himself to decide what shall be produced and how. So far as he can manage it, the producer tries to preserve his vested interests by monopolies, cartels, restrictive practices and monopolistic economic warfare. Insofar as he is not successful, he tries to ensure that his vested interests shall be protected by political pressures and by lobbying governments and legislators.

The problems of instability and of monopoly have both become involved with political power. For even the «best» solution to these problems, according to market principles, may put in question the interests of individuals, and of strata, or sectors, of society. Certainly the state, according to the assumptions of the market economy, should remain neutral, and act as a referee for its citizens, leaving to each and everyone taking part in the economy that measure of success or failure, fortune or misfortune, which the rules of the market assign to them. But the state may not be able to preserve this kind of neutrality, because citizens, groups, and parties insist on maintaining their vested interests, or the fruits of good fortune, against the rules of the game, by shaping the policies of the legislators and the government accordingly.

It is not simply a question of a conflict between those concerned with the functioning of the market sector and those devoted to shaping the framework, or «data» of the political and social order; or of a conflict between supporters and opponents of the market economy.

What confronts us here is rather a general rebellion of the broadest sections of those engaged in the economy, whether they are supporters, or critics, or opponents, of the market system, who, at least when it comes to their own personal interests, are prepared to demand that the market system can go to hell so that special rules of the game, and a special slice of the cake, shall be cooked up for them, contrary to market principles. The agents in this process of anarchic disintegration are countless: workers against entrepreneurs, consumers, and the owners of land and capital; entrepreneurs against workers, consumers, and those not remunerated through markets; bureaucrats for their own vested interests against all other vested interests; one sector against all others; agriculture against the rest of the economy; one trade against every other possible interest.

The only people who cannot take part in this game of mutual destruction are the consumers. Although they consist of all members of society, they always come off worst as compared with each and every partial interest. This whole collection of exploiting gangs is confronted simply by a deplorably small stratum of intelligent politicians, including the Minister of Economics, and a number of deputies, writers and economists. These are denounced by the whole united (or disunited) chorus of interest groups, as ideologic, remote from their subject and the real economic world, or as legal pedants, or envious «theorists».

So here too there is ample scope for «left-wing» and «right-wing» approaches to the market economy, and for those who will mutually monitor one another's activities and call attention to one another's errors. The entrepreneurs, on the other hand, in contrast with their emphatic declarations in favour of the market economy, are more inclined, at least, to contribute to its general abuse and destruction. In fact, the most radical and comprehensive socialist attacks on the market economy, such as that of Marx, do not undermine the market's authority as seriously as the unscrupulous and ignorant cynicism from inside the camp of those who are supposed to be supporting the market.

The polemic against «a market economy of the left» also has another objective. The attitude of the SPD (= Sozialdemokratische Partei Deutschlands) is mistrusted and regarded as hypocritical vote-catching. But to the extent that the belated support of the market economy by the SPD is genuine, then the authors of such polemics are in the wrong. The impression is conveyed that the SPD, and any of those describable as holding «socialist» views, are to be denied the right of supporting a market economy. The market economy is to be regarded as the exclusive patent of employers, entrepreneurs, and the owners of land and capital, that is, of the bourgeoisie. It is demanded that the socialists, before they may support the market economy, must publicly declare the bankruptcy of socialism and perform a public, Cannossa-like, act of recantation.

We may leave on one side the question as to whether, and to what extent, there is among the SPD today [1953] a genuine commitment to the market economy. It will certainly not be doing any injustice to those socialists who are favourably inclined to the market economy, to assume that the kind of economy which they envisage is one that can be adapted to certain political objectives; and, moreover, that they may be considerably overestimating the extent to which the market economy can be thus manipulated. Nevertheless, if the market economy is going to be taken seriously by a significant body of socialists as a possible, discussable instrument for the purposes of a socially just order of society, this would certainly be an event of the greatest significance, both politically and for the history of ideas. Who can foresee today the consequences to which such a significant first step might lead?

It would be a complete misconception to assume that to be favourably inclined towards a market economy necessarily requires the renunciation of socialism. Historically, socialism, before and since Marx, and down to the present day, has consisted of two elements: one is a concern for humanity, and the other element has consisted of changing recipes for fulfilling this concern for humanity, – which is by no means an objective only of socialists. Their concern is for securing for everybody, especially for the most numerous classes, the greatest possible share of material goods, together with social and political freedom and independence, as well as opportunities for education, personal development, and an influence on the life of society. On the other hand, the programmes for achieving these objectives, both before and since Marx, have undergone decisive changes, and will continue to do so in the future.

The fact is that there is only a very limited number of ways, in principle, of ordering the economy of a society, and that each of this limited number of possibilities, according to its particular characteristics, is related to each of the others in various ways, which are well understood by intelligent people. Therefore, it is incomprehensible that those who profess a concern for humanity, and call themselves «socialists», should be denied the right to choose, on the basis of experience, between different technical or instrumental possibilities: or that they should be denied the right to call themselves «socialists» if they come to the conclusion that their objectives can also be realised through the use of a market economy. That the socialists themselves have denied this for a hundred years does not constitute a valid reason for their not ceasing to deny it today. Anyone who puts a high valuation on the power of markets to organize economic life; or anyone who appreciates the ability of markets to reduce to a minimum irrational resistance to change, inertia, and anti-social selfishness, without incurring significant administrative costs; or anyone who prizes highly their own freedom, and is convinced that the market economy can rise to decisively improved, and previously unattained levels of performance: any such people can only be delighted when a major socialist party today begins to replace its previous slogan of «Down with the Market Economy», and the kind of denunciations of the market which they made earlier in this century, with the slogan «Market Economy of the Left».

It was impossible to create a fully-fledged market economy in a free society so long as such a large and important part of the economically productive, including the labour force and other sections of the population, remained opposed or hostile to this kind of economic order. More especially, the degree of improvement which is attainable in this kind of economic order is ruled out. It is also impossible to bring into being politically a really successful market economy, together with its appropriate social and political framework, if it is only supported by those sections of the population who can look forward to special advantages, in terms of the distribution of income, or in terms of their own opportunities and influence – (including the possibility of managing an enterprise). For these sections of the population – as we observed above – are not, in fact, reliable supporters of the market economy. They are much more influenced by the understandable human striving to safeguard vested interests, avoid risks, and hold on to power, and so are under a constant temptation to undermine or replace the market order.

What could be more fruitful than political competition between bourgeois and labour parties regarding the best or most socially beneficial way of bringing about a market economy? «Market Economy of the Left against Market Economy of the Right»: this could be far from the worst kind of development, or conflict, which could happen in our country. Probably it is the only way of bringing about an effectively and beneficently working market economy.

Ethics and Economic Life

Wilhelm Röpke

1955

1. One notable, albeit sometimes overlooked aspect of economic life is that moral issues have engaged the attention and energies of political economists from the very beginnings of this branch of science. No less a person than *Adam Smith*, whose book the «Wealth of Nations» (1776) made him the real founder of the science of economics, also wrote a work entitled «Theory of Moral Sentiments» and this still arouses enthusiastic notice today. Hence, even a modern-minded economist need not feel ashamed if, when pondering over exchange rates, balance of payments and cycling policy, he suddenly finds himself confronted with very fundamental issues within the field of moral philosophy – issues which demand an answer.

We economists would indeed have to be very hard-boiled not to be stirred by these questions. Those who dedicate their hearts and minds to this science are faced with occasional doubts as to whether they are perhaps concerned with a sphere of human thought and action which, although of fundamental necessity, is for this reason marked by certain ignoble features. *Primum vivere deinde philosophari* – perfectly true: but does this proposition not simultaneously imply a certain scale of values? And does not the Gospel teach us that man does not live on bread alone – an admonition that, although man needs bread, he must direct his thoughts to higher values?

If we are free from such scruples and misgivings – and that is certainly nothing to be proud of – other people make sure that they do not remain concealed from us. And that reminds me of an altercation I had the honour to have with *Benedetto Croce*, one of the great European thinkers of our time, a few years before his death. As our dialogue throws abundant light on the matter in hand, I shall report it in brief.

I had propounded the thesis, now known to everybody and certainly no longer controversial in any way, that every society, in all its aspects and sectors, invariably forms one unit in which all parts fit into a pattern of mutual dependence. It is, moreover, an entity which we cannot simply compose as we please. This would apply in particular to the regulating of

economic life, which must be seen as part of the overall social structure and which, moreover, must be in accord with the established political and cultural order. I argued that we are not free to combine any sort of economic system such as a collectivist one with any politico-cultural order of our choice. If we want freedom in the political and cultural sphere, we must opt for it in the economic field as well and reject any collectivist economic system because this is inevitably based on servitude. Moreover, it should be clear that a collectivist economic system would jeopardize freedom in the political and the cultural sphere. In other words, freedom and all its implications for genuine humanity and ethos ensuing from the immutable criteria underlying our civilization ought to be defended as far ahead as possible on the economic front.

This means that, above all, economists in our time have the difficult and honourable task of fighting for freedom, personal integrity, the constitutional State and morality which can only subsist in freedom. And, indeed, they ought to fight for them at the most exposed point of the front by turning their whole intellect to the vital question of how the theory of a largely free economic system can be translated into reality under the very difficult conditions prevailing today in our modern industrial society and how this system could be made immune to the daily hazards of collectivism.

These were my arguments. And what did *Croce* reply? Not much, apart from the cardinal point (in his view) that the correlation between intellectual-political and economic freedom did not exist. The only important thing was the former. As for economic freedom, it belonged to a lower, independent sector in which we could decide as we thought best. That was only a matter of expediency in deciding the mere organization of production and an issue which ought not to be mentioned in the same context of the decisive and much more sublime question of freedom as a spiritual and moral issue. This did not concern a philosopher, who might be a liberal in the intellectual and political sphere, yet a communist in his economic views. According to *Croce*, the important thing lay in seeing liberalism as a movement fighting for intellectual and political freedom, whereas the defence of economic freedom had to make do with the (in his mind almost disparaging) term of «liberismo».

It has always been incomprehensible to me how such a distinguished thinker could have misjudged the status of economic life and its place in society in a manner which today hardly warrants consideration and which is no longer defended even by *Croce's* immediate disciples. However, recalling this dispute to our minds has its beneficial side, too.

2. Naturally, nobody would think of denying that the economic side of social existence, of supreme interest to professional economists like ourselves, must be inspired by profound motives and objectives. To take a somewhat drastic example, it is neither the sublime beauty of a cathedral nor the spiritual conception behind it which attract economic study, but the worldly material question as to what place these monuments of worship and beauty occupied in the economic texture of their age. *Pierre du Colombier* drew a charming picture of this in his delightful book «Les Chantiers des Cathédrales». We know that it is, so to say, this sober backstage setting which interests us economists. If however the materialist approach to history designates the intellectual and political life of the nation as the mere ideological superstructure of the productive apparatus, we can sense in it the almost derisive unmasking character of such a philosophy of history. That other approach serves to demonstrate our awareness of the true sequence of priorities.

All this is so evident that any further statement about it would seem superfluous. But equally evident is what we retort when asked to accord economies, as the object of our inquiries, its due place in the world of intellect and ethics. How much aristocratic arrogance pervades all the disdain shown towards economic matters! How much ignorant disregard for the sum total of work, renunciation, pioneering spirit, honesty, and performance of duty it reveals – qualities on which the very life of a huge and daily growing world population depends and which support the whole edifice of our culture! Without them, there would be no freedom or justice; no dignified human existence or solicitous individual help. We can but

quote *Hans Sachs* in the final act of «The Mastersingers» who, in his annoyance, shouts at *Walter von Stolzing*: «Do not scorn our master craftsmen».

And yet we must also be on our guard against exaggerations in the other direction. There is a type of economics which substitutes the means for the end and only thinks of the daily bread instead of higher values, as the Gospel recommends. This elevation of the means results in a materialism which tends to direct the whole weight of our thoughts and our activities to the gratification of our immediate sensual wants. There is also utilitarianism which, since the days when this smooth philosophy of practical usefulness propagated by *Bentham* in England started on its way round the world, has fatally distorted our criteria and disrupted our scale of ethical values in a lamentable way. Those in search of an extreme example to illustrate this disintegrating aberration should read the famous essay written by *Macaulay*, more than a hundred years ago, in praise of *Francis Bacon*, the founder and father of utilitarianism and pragmatism, an essay culminating in the remarkable statement that he preferred any good shoemaker to a philosopher like *Seneca*, because shoes were more useful than moral observations on anger. As if shoes and all the material benefits conferred upon us by technical advancement could really help someone who, without being fully aware of it, has lost, in the midst of a society dedicated to the cult of what is useful, his intellectual and moral bearings! Such a person cannot fail to remain unhappy and dissatisfied in all eternity. As if it were not our bad luck to see how the whole of the intellectual legacy of classical antiquity and of Christianity, to which even a *Seneca* contributed a commendable portion, has meanwhile been wasted and dissipated!

We ought to be on our guard against such exaggerations and distortions. Moreover, it is by no means paradoxical if we, in our capacity as economists, make a point of warning others to over-estimate the economic side of history and to ensure that other forces and motives achieve the full recognition which they deserve. Though we do not scorn economic utility, we have no desire to see it tyrannize us by insisting on our sacrificing the beauty of our respective countries to ubiquitous advertisements or the rights and happiness of the weaker members of the community to a form of progress solely defined in terms of kilowatts and horse power. We ought not to be mere economists but also philosophers who disregard neither the natural order of things nor the true scale of values. In that case, we need not have any doubt that the decision in the struggle between communism and the Free World will be reached not so much through the contest in material living standards as in the field of intellectual and moral values. We know that the fortunes of communism depend more on empty souls than on empty stomachs and that the Free World will only win through if it contrives to fill this void in its own way and with its own values. Its answer to communism is not the cult of material comforts and the Welfare-State – for that would imply moving on to the philosophical terrain of communism – but the higher values of human existence: freedom, truth, justice, dignity, respect for individual life and for the fundamental things, genuine and natural communities, careful preservation and reinforcement of the spiritual and religious foundations of all such values and benefits, and finally the promotion of traditional and acceptable forms of existence and natural order designed to offer support and protection to all these qualities.

There are those who see communism as an evil and bitter fruit of poverty. But it is, in reality, the social crisis of the present age on the whole marked by the disintegration of the social structure and of its intellectual and moral foundations, thus allowing the pernicious phenomenon of totalitarianism to rise in the form of today's communism and yesterday's national socialism. This totalitarianism prospers wherever the humus of a healthy way of life and communal existence has been washed out by proletarianization, social erosion, and by measures to destroy the middle- and the independent-farmer classes. It prospers wherever people have lost their roots and their firm hold, wherever they have been prized out of the basic social unit of the family, the nexus between the generations, their neighbourhood links and other genuine communities and wherever these disintegrating social processes are

accompanied by a process of religious and intellectual uprooting. Totalitarianism gains ground wherever people suffer in this process of decomposition as the victims of an inner dissatisfaction and stunting of their whole existence. In other words, whenever they suffer from a continuous loss of the genuine and intangible prerequisites of simple human happiness. Their existence exhibits an inner emptiness, a void which, in the long run, cannot be filled with motor-cycles, refrigerators, radios, television sets and cinema tickets.

3. All these considerations merely serve as an introduction to the real problem with which we are dealing here. We have already allowed our thoughts to roam across a wide field, but it may well be that the report on my discussion with *Benedetto Croce* contains more than meets the eye at first sight. But, in essence, our main concern up to this point has been to assign to whatever economic activity we are considering its true rank in the light of our scale of ethical values.

We have not yet gone into another, more concrete question, which attracts the foremost attention of people today when economy and ethics are to be correlated. The issue is this: whatever status the economy may hold in general, what is the ethical rank of the economic order specific to the Free World and whose laws and processes make up the essential contents of what we call economic science? What ought we to think of the ethical foundations of a free market economy? Do not some of our economic concepts belong to an ethically somewhat uncomfortable and awkward sphere? I refer to such matters as demand and supply, profit, profitability, competition, interest and freely operating forces etc in order to characterize the free form of an economic order which allows the individual to choose for himself – an economic order which we find, at least in part, throughout the Free World. Does not all this belong to a sphere morally somewhat questionable, if not doubtful? Or, let me put it more forcibly: do we not live in an economic world which stimulates a blatant greed for gain and which fosters a commercial machiavellianism based on the ends justifying the means and a paganization of economic life? It not only fosters it but seems to make it a rule – as the Communist Manifesto has pointed out – to drown all higher feelings in the ice-cold water of egoistical calculation or, in the words of the Bible, to let people conquer the world but lose their souls. Is there any better way of completely scorching a man's soul than the habit encouraged by our economic system of allowing people's thoughts to dwell permanently on money and material things? Is there any more potent poison for genuine culture than a commercialization which pervades everything?

I know people – and some of them are close associates of mine – who protest against such questions or would prefer to delegate the matter, with a touch of irony, to theologians and philosophers. They could hardly be perpetrating a bigger error, particularly if they support the economic system to which these questions relate (not only because of its material yield but also because of its insistence upon freedom and justice i. e. the supreme ethical values) and thus apply criteria taken from the theologians and philosophers and their own ethical conscience. They consider themselves tough in economic matters while their reasoning, unconsciously, moves along ethical lines which truly does them credit. They are, as it were, sheep in wolves' clothing.

Above all, they do not seem to realize as we pull ourselves more and more out of the slough of mass poverty that our economy is being judged on a growing scale in terms of those criteria of which we have been speaking. We cannot take these problems seriously enough, unless we wish to turn a blind eye to the fact that it is neither the most stupid nor the most deprived of our contemporaries who are driven into the arms of collectivist radicalism because they cannot find a satisfactory answer to our questions. Very many people who can justifiably call themselves convinced and serious Christians are to be found among their ranks. Should we not try to help them to find the right answer and to show them the moral foundations of our economic order as well as the points at which those foundations are jeopardized?

But there also ought to be another and no less important reason for our concern with the

ethical content of the trivial subject of everyday economic life. This reason must be sought in the region where we come upon the ground-water into which the roots of our individual lives dip and from where they derive the sap of life. On the front of an old seaman's house in Bremen stands the inscription: «navigare necesse est, vivere non est necesse». The drift of this Latin tag is clear. There can be no real life for us if we pursue our occupation simply to make a living without discerning in it an inherent compulsion stretching beyond the mere desire for pecuniary gain and a thrust which imparts to such an existence inherent dignity and spiritual satisfaction. Whatever we do and whatever work we carry out, we must know where we stand in the great social pattern and what the point of our whole being is, i. e. apart from the indirect aim of feeding ourselves and our families. We must render account to ourselves of our social functions, for which society remunerates us in the form of income. We are truly leading a paltry life if we remain unaware of this fact and if we regard the hours devoted to work simply as a means of acquiring money and as a debit item in life's balance-sheet – compensated solely by the credit item of gratifications attainable with the monetary compensation we receive for our work.

This awareness of the sense and dignity of professional life and the social status of work, whatever it may be, is no longer present in an alarmingly large proportion of men and women. Arousing this awareness ranks among the most urgent tasks of our age. It is a task, above all, for the teachers of economics; a task whose solution necessitates the analytical skills of economic thinkers linked in felicitous union to the sensitive approach of a social philosopher. In many cases, this applies in a special degree to those engaged in commerce, since it seems difficult in their case to determine the place in the social pattern which is allotted to them by virtue of their functions. Viewed from outside, their activity appears to consist solely in the repeated act of buying and selling; and it does not reveal its social purpose and intrinsic dignity as readily as that of the farmer or mariner. And how much more difficult is it to make clear to a layman the function of a stock-exchange speculator, or to overcome the almost ineradicable prejudices attaching to this favourite target of anti-capitalist criticism!

4. So what is our reply to the fundamental question from which we proceeded? What is the customary ethical plane on which trade and industry operate in our free societies of today? In some respects, the situation is not unlike that of the average person on whom *Pascal* made his famous comment: «ni ange, ni bête». *Pascal* went on to explain that we only make a man into a beast when we try with might or main to turn him into an angel. We are, then, marching along a plane of medium elevation. It is neither the peaks where heroes and saints reside in an atmosphere of pure altruism and disinterested dedication nor of free leisure nor is it, on the other hand, the morass of an open or hidden struggle in which violence and cunning decide who shall come to harm and who shall come to riches.

The fact that we draw in our economic terminology on both these metaphorical planes (and usually aspire too high or too low in so doing) is very typical of our feeling of uncertainty. Yet it is evident when we speak of «customer service» that we have in mind the filling-station attendant wiping the windscreen rather than St. Elizabeth. When we talk of conquering a market, that conjures up a vision of samples of goods or the rattle of machinery, and not the thunder of tanks. True, our middle plane of economic activity can produce elevations into the higher sphere of true dedication and equally often sink into the quagmire of violence or deception. Yet few people will seriously deny that the world of transactions, negotiations, calculations, speculations, offers and market research morally corresponds to the conditions of everyday middle-class life. Many imperfect formulae have been submitted to describe the ethical atmosphere of the world of commerce: a spirit of individual responsibility, an initiative born of the desire for gain, yet aspiring to satisfy the wishes of others as far as possible, an assertion of our own interests coupled with a willingness to achieve a balance with our neighbours' interests, cooperation in the guise of rivalry, solidarity, a constant weighing of the significance of our own contribution on the

scales of the market, and a continuous struggle to provide the best objective performance whilst promoting our own position as the price of participation in the contest. It is a mild atmosphere without passion and enthusiasm but also, to use *Heinrich Heine's* words, «without any great vices or any major blood-stained crimes». Although this atmosphere may not nourish the soul very noticeably, it certainly does not poison it either. But it is conducive to the pervasion of a mild breeze of a minimum of considerateness, promoting the elementary justice of a concurrence between performance and counter-performance and the creation of an atmosphere in which productive energy can flourish best. Perhaps the greatest asset in the balance-sheet is the fact that this development does not serve to construct pyramids, but continuously to raise welfare for the masses. It does so under the impact of the tremendous forces peculiar to the structure and ethical character of our free economic system. In this assessment of the moral climate of market economy, we are in agreement with the great minds of the past. In his famous book «*L'esprit des lois*» (1748), *Montesquieu* wrote of the spirit of market economies that they evoke a certain feeling of justice among men, in contrast, on the one hand, to depredation and, on the other hand, to those moral virtues that induce people not to insist ruthlessly on their own advantage and to neglect their interests in favor of those of others (Book 20, chapter 2). To this we would add the observation that our current social pattern, based on a free market economy («capitalism»), can justly claim to be the least coercive régime in the history of all times.

When *Heinrich Heine* writes with biting irony of «self-complacent virtue» and «morality dependent on solvency», we know that we are experiencing the disdain for economic affairs of an eternal romanticist in whom the reactionary is linked to the revolutionary and the irresponsible aesthete. For centuries, a certain blemish has been attached to that middle rank in ethical values held by every essentially free economy. One of the inestimable services rendered by the social thinkers and philosophers of the 18th century – from whose works modern economic science originates – consists in liberating commercial and industrial activities from the stigma of the Feudal Age and in procuring them the moral standing to which trade and industry are entitled and which has today become a matter of course. That middle-class philosophy, which in a judiciously defined sense we can term «liberal», has taught us to acknowledge with honesty the desire of the individual for self-development and self-assertion both for himself and for his family and to accord due recognition to the concomitant virtues of hard work, enterprise, thriftiness, sense of duty, reliability, punctuality, and rational behaviour. This philosophy has taught us to regard those who stand on their own feet and make their way despite all difficulties as the indispensable fountain of bubbling life and as a creative force which is life itself and without which it will simply wither. This has unleashed the energy without which our present world and our whole cultural system are inconceivable.

These «interested» activities have thus become a positive factor and the motive force in society, culture, and economic life. And those who protest against this in the name of Christianity reveal that they have not yet overcome the phase of eschatological communism set out in the Acts of the Apostles. Finally, the doctrine of individual self-assistance, which forms the fundamental ethical doctrine of political economy, was just as clearly enunciated by *Adam Smith* as in the New Testament. This point was made by the famous English historian *Lord Acton* in his «History of Freedom and Other Essays» (1907) and he also rightly observes that we had to wait for modern times before the truth of this was recognized. But just in case the Catholics among my readers should believe this to be a Protestant line of thought, let me quickly add that *Lord Acton* was a true son of Rome. Let us take a look at economic developments in literature. When *Shakespeare* places a merchant on the stage by way of exception, it is at best a *Shylock*. But what a long way from that to *Goethe's* «*Wilhelm Meister*» where we are confronted with a world of bourgeois trading and where even double-entry bookkeeping is idealized in philosophical and poetic terms!

All of this becomes twice as clear when we turn the tables and ask what would happen if we let those people have their way who condemn markets, profits, competition, and self-interest in the name of «higher values»? It becomes manifest that they are violating a side of human nature which truly forms part of life and one which must counterbalance the other side, i. e. dedication. As they demand too much of the average person and expect constant abnegation of his own interest from him, the proponents of such views would be depriving the community of the immense motive power which originates from such urges. Secondly, these champions of such exalted economic ethics find themselves perpetrating something highly immoral in order to enforce their goals, namely continuously compelling people to act against their nature either by force or else by cunning and lies. In all countries where a collectivist order has been set up in the name of many different things including an allegedly higher moral standard, the population is kept obedient and dutiful by police control and by punishment and at the same time intoxicated by a fanatical ideology and an inflammatory propaganda. As we all know, that is the usual outcome of any attempt to replace a free market economy (which has the capacity to direct individual energy and diligence on to the turbines of the economic machinery) by a collectivist economy with its need for heroes and saints if it is to function in a satisfactory way – thus invariably leading to a police State. In other words, any attempt to establish an economic order on a moral code considerably more demanding than the average human approach must eventually lead to coercion and organized intoxication of the masses by lies and propaganda. . . . «et qui veut faire l'ange fait la bête» (*Pascal*). That is one of the main reasons for the familiar situation that freedom in the State and in society presupposes freedom in the economy and, on the other hand, that a collectivist economic order ends in poverty and tyranny. Yet this is apparently a consequence which represents the opposite of «morality». If a denial of the positive value of acts dictated by enlightened self-interest conduces to the destruction of culture, then it furnishes clear evidence of that value.

We would, however, gain a lop-sided and unfavourable picture of the ethical fundament of our economic system if we wished to reduce the motives of economic action to mere material gain. Yet a homo oeconomicus of that stamp is just as rare as heroes and saints. On the contrary, the motives which carry people to economic success are as manifold as the human soul itself. It may well be that the wish for profit and power inspires people, but so does delight in creative activity and the wish for distinction. So does the urge to improve results; the sense of duty; the dream to discover Troy (*Schliemann*); the desire to help and to bestow gifts; and thousands of other things. But even if we discover nothing better than the impulse of a blatant desire for material gain, we should not forget that those who look after themselves and their dependants by means of their own energy and responsibility are not doing anything mean or contemptible. At any rate, they are more worthy of our sympathy than those who wish to leave this worry to others in the name of a higher social morality or those who pride themselves on being generous at the cost of others.

It is self-evident for a trained economist that, in all these matters under consideration, there lies our familiar answer to the obvious question of what happens when individual motives lead to activities which tend to harm our neighbours. In this sphere, the «liberal» social philosophy of the 18th century to which we referred above has taught us to see an economy resting on division of labour, exchange of goods and free competition as an institution which, despite its abundant and often provocative imperfections, at least exhibits a tendency to coordinate activities propelled by self-interest with the interests of the whole community in a manner not achieved by any other economic pattern. It does this by inducing the individual, through competition, to view his own success as consisting in the degree to which he serves the market, i. e. the consumers. Those who obey the wishes of a market characterized by freely fluctuating prices will be remunerated by gain just as those who disregard these wishes will be punished by losses and finally by insolvency. The making of a loss or a profit in economic activity – and the precise ascertainment of this is the main aim

of business-management studies – thus becomes an indispensable guideline for rational trade and industry. That is something which a collectivist economy tries in vain to replace.

5. There is no need to waste any ink on pointing out how over-simplistic and inadequate these laconic formulae are, however undeniable their underlying truths may be. It is superfluous to point out in how many increasingly numerous cases the market and competition prove unable to solve the immense problem of coordinating individual commercial decisions with overall economic interests. It is equally unnecessary to stress the difficulties of shaping competition in a free and satisfactory manner. As we know, all these unresolved questions and problems make up the difficulties of an active economic and social policy which cannot be taken seriously enough.

This is not the place to discuss these any further. There is, however, a greater necessity to stress another point. Have we in fact said all there is to be said when we emphasized the importance of competition and the price mechanism which it governs as the great regulator of an economic system which does not impede the liberty of individual forces? Is it sufficient to appeal to a kind of «enlightened self-interest» in men and women to consider it most advantageous and beneficial for them if they submit to the discipline of the market and of competition?

The answer to this must be a resounding «no» and, in so doing, we draw a clear-cut dividing line between ourselves and the liberal utilitarianism and immanentism of the nineteenth century, whose influence is still manifest today. Indeed, there is a theory which we can only designate as liberal anarchism if we recall those who believe that the market, competition, and economic rationality constitute adequate replies to the question of the ethical foundations of our economy.

What is the truth? The truth is that everything holds good we have said about those forces which, under our economic system, bring their influence to bear on the «middle line» in economic ethics, yet only on the tacit assumption of the existence of a minimum number of basic ethical convictions. In other words, economic life does not take place in a moral vacuum. Rather it runs the permanent risk of losing its middle ethical line if not underpinned by strong moral supports, which must exist and be continuously reinforced. Otherwise, the free economic system and with it our free State and social system is bound to collapse.

In the first place, this applies in the narrower sense that competition must be continuously protected against the trend towards adulteration, restriction or degeneration. But that implies that individuals not only subscribe to free and honest competition, but also behave accordingly in practice. Every individual and every group participating in economic life (including trade unions) must make a permanent moral effort at a self-discipline which leaves as little scope as possible for the State to impose and enforce tasks and compulsory discipline upon us. We must not believe that it would be sufficient to leave it to the enlightened self-interest of these groups and individuals and to appeal to their common sense on economic matters. Within certain limits, institutions such as cartels and trade unions or pressure groups and central associations can serve their interests very efficiently if they try by means of monopolistic pressure or influence to obtain more than would be warranted under genuine and honest competition. We must invoke more exalted ethical values: justice, a sense of communal responsibility, goodwill, and sympathy.

And thus even the prosaic world of business affairs draws on the ethical resources with which it stands or falls and which hold greater importance than the whole gamut of economic laws and principles. It is not the market nor competition nor the interplay between supply and demand which create these reserves. In fact, they consume them and must draw reserves from areas beyond the market. Nor can they be replaced by any manual of political economy. Qualities such as self-discipline, a sense of justice, honesty, fairness, chivalry, moderation, public spirit, respect for human dignity, reliable ethical standards – all these are things which people must already possess when they enter the market. They are the indispensable mainstays affording protection against degeneration. The institutions which

endow them with these qualities are the family, the Church, genuine communities, and traditions. People must also grow up in conditions which favour such convictions and concepts, conditions peculiar to a natural system which promotes genuine communities, respects traditions and looks after individuals. Property, reserves of all kind, and an appreciation for both of them form essential elements in such a system – without which something as important as a sense of responsibility cannot thrive.

When we characterize a system like this as a middle-class order in the widest sense of the term, this is the fundament on which the ethos of economy must rest. This system sets out to promote not only independence and a sense of responsibility in the individual but also the civic sense which links him to the whole and limits his appetite. In this field, moral authority of that thin layer of *nobilitas naturalis*, readily accepted by their fellow-citizens, proves to be indispensable – a layer to which a handful of them aspire by virtue of an exemplary life of self-denial and hard work, rigorous integrity and fine example as they ascend to a position above the classes, interests, passions, hatreds, and follies, thus embodying the moral sense of the nation and culminating in such supreme figures as *Fridtjof Nansen* or *Albert Schweitzer*.

Only in this way man with his dual nature – as an individual left to his own devices and as an aspirant to a complete whole – can find true justice and become the fundament of a permanent, prosperous and humane order of things. Only in this way can the ethos of the economy be genuinely secured and be freed from its instability.

Nevertheless, there is another spirit operating against these forces – a spirit, essentially also a product of the beneficial, albeit fatal eighteenth century, which reduces man to a mere collective unit and society and the economy to a mere mechanism. This spirit celebrates its greatest triumph in collectivism, but it has already become a dangerous element in our non-collectivist social and economic philosophies. Computers, mathematics, statistics, blue-prints, and organization charts seem to triumph over man in this sphere.

This spirit of drawing up schemes which leave no place for man is in every respect a grave danger and it must be fought with vigour. It constitutes a new outrage upon the human race and a sham solution of the basic ethical problem. Such a spirit clashes with the true nature of the economy which never fails to bring our thoughts back to man and to his soul. The fact that those in economic life are confronted with this true nature of mankind and thus also with the imponderable, immeasurable and the uncertain in life and that the matter at stake is one of constantly weighing and taking risks – these are the things which round off our picture of the true ethos of the economy.

6. But these observations would still be incomplete without a few last words to our own fraternity of economists, thus linking up the beginning and the end of this survey. A French sociologist *Lucien Romier* already wrote over 20 years ago in his publication «*Si le Capitalisme disparaissait*»: a cultural system cannot survive in the long run if the masses on whose shoulders it rests no longer understand its inherent laws, its structure, and its real sense. Yet it is particularly this understanding of our economic system which has got lost as its machinery became more and more complicated. Making the economy comprehensible and transparent and explaining its workings to everyone in simple language and showing him precisely where he stands in this economy is one of the foremost responsibilities economics and economists are confronted with today. Yet this task presupposes that we all regard the need for an understandable explanation of this difficult science as necessary and urgent.

But economic science has another very special function to fulfil in a modern democracy. It has the modest, yet even more useful mission to give free rein, in the midst of the hurly-burly of politics and the interests of the economy, to the incorruptible logic of events, to throw light on inconvenient facts and circumstances, to observe a judicious sense of fairness in placing everything where it belongs, to prick soap-bubbles, to unmask illusions and confusions and to defend, against the whole world, the simple fact that two times two are four. Economics is predestined to be the anti-ideological, anti-utopian, debunking science par excellence. In this respect, it renders society the inestimable service of cooling the fever

of political passions, fighting against mass myths, making life miserable for all the demagogues and financial whizz-kids and economic conjurers, whilst, at the same time, making sure that it does not itself become the willing slave of emotions.

That, too, forms one side of our theme «Ethics and Economic Life» and indeed the side for which we economists are ourselves responsible. It is always awkward to have to speak of the ethical conduct of others, and we therefore ought to welcome an opportunity to start with ourselves.

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Symposium III

Sicherung und Fortentwicklung der Sozialen Marktwirtschaft Ordnungspolitische Aufgaben

1979. VIII, 275 S., kart. DM 38,—

Seit Jahren ist die Ordnungspolitik in die Randzone der Wirtschaftspolitik geraten. Sie ist aber der Kern der Sozialen Marktwirtschaft. Wo liegen nun heute, nach dreißig Jahren, in denen Soziale Marktwirtschaft trotz Regierungswechseln und damit verbundenen ideologischen Differenzierungen das Fundament unserer Wirtschaft geblieben ist, die offenen Probleme der Ordnungspolitik? Wie lassen sie sich lösen?

Die Ludwig-Erhard-Stiftung hatte einen Kreis von Wissenschaftlern, Politikern, Wirtschaftsjournalisten und Praktikern eingeladen, um diese Fragen zu analysieren.

Symposium IV

Wilhelm Röpke — Beiträge zu seinem Leben und Werk

1980. VI, 124 S., kart. DM 28,—

Am 10. Oktober 1979 wäre Wilhelm Röpke — er starb am 2. Februar 1966 — 80 Jahre alt geworden. Das aus diesem Anlaß von der Ludwig-Erhard-Stiftung veranstaltete Symposium sollte die Frage klären, in welchen Beziehungen Wilhelm Röpke, einer der wichtigsten Klassiker der modernen liberalen Theorie der Sozialen Marktwirtschaft, für die Gegenwart verbindlich geblieben ist und für die Zukunft verbindlich bleiben wird.

Symposium V

Informationstechnik und Liberalität

1980. VI, 153 S., 23 Abb., kart. DM 28,—

Die Entwicklung der Computertechnik hat Auswirkungen auf die Entwicklung der Wirtschaftsordnung der Sozialen Marktwirtschaft. Vor allem die Befürworter zentralistischer Lösungen verbinden mit der zunehmenden Leistung der Computer die Hoffnung auf Möglichkeiten, differenzierte staatliche Gesamtwirtschaftspläne aufstellen und ausführen zu können. Zur Diskussion aller damit verbundenen Fragen und Perspektiven hat die Ludwig-Erhard-Stiftung ein interdisziplinäres Symposium veranstaltet.

Symposium VI

Brauchen wir wirtschaftliches Wachstum?

1981. VI, 97 S., kart. DM 24,—

Die Ludwig-Erhard-Stiftung hat die Frage „Brauchen wir wirtschaftliches Wachstum“ in einem Symposium mit maßgeblichen Politikern und Wissenschaftlern eingehend erörtert. Angesichts großer neuer Probleme, die sich der Wirtschaftspolitik in den kommenden Jahren stellen werden, ist es wichtig, nach der Bedeutung des wirtschaftlichen Wachstums auch hinsichtlich der Lösung dieser Probleme zu fragen, denn weder die Linderung der weltweiten Not noch die Wahrung eines sozialen Friedens — national wie international — werden ohne wirtschaftliches Wachstum möglich sein.



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